PUBLIC FINANCE

International quarterly journal devoted to the study of fiscal policy and related problems

FINANCES PUBLIQUES

Revue trimestrielle internationale d'études de finances publiques et de problèmes annexes

Vol 12

No. 1 / 1957
No. 2 / 1957

PUBLISHER/EDITEUR
"PUBLIC FINANCE/FINANCES PUBLIQUES"
DIR. DR. J. A. MONOD DE FROIDEVILLE
HAARLEM
NETHERLANDS/PAYS BAS

SWETS & ZEITLINGER N. V. - AMSTERDAM

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GOVERNMENT SPENDING: ISSUES OF THEORY AND PRACTICE

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Agreement on what is the wisest total, and pattern, of government spending is a goal men are never likely to reach. If they do, they must expect dispute to appear quickly, for conditions change. Needs and opportunities differ significantly from one year — and certainly from one decade — to another. The reasoning, and the emotion, that guided decisions in the past which affect government spending today need reconsideration as social life develops. We may now be spending for things which are relatively much less important than when the decisions were originally made. Or we may now have opportunities to achieve important goals by adding a type of expenditure not deemed possible in the past.

This paper discusses a few issues of theory and practice that seem inadequately recognized in the literature of economics. Articles on "pure" theory of government spending have added to my immediate interest, but the comments here deal primarily with less abstract considerations.[1]). Although I am not unfamiliar with public finances of some other lands, conditions in the United States dominate my views here. This article makes no pretense at systematic coverage. Yet no modern theory will be complete without incorporating the insues considered here.

Measuring the Elements Involved

One economic reason for the public to use government, rather than other forms of organization, to achieve objectives is the belief that some activities bring substantially greater social benefit than others. The business economy — the public operating through markets — will not devote enough resources to activity that is especially rich in social benefits. Why? Private firms cannot appropriate, become the owners of, all the positive results of their operations. A business must pay as much to get resources as they can command in the market. Yet it cannot recoup more than the value of the marketable services they yield, and these are sometimes significantly less than the total product. If the public can go beyond the market by using government, it can hope to expand real income.

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1) My views have developed gradually, and I cannot give credit where it may be due. I do wish, however, to thank Dr. Julius Margolis for access to some unpublished material.

Buying resources at the same price as private business, it can use them more extensively in activities with exceptionally large social benefits. Or it can subsidize private outlay that produces such results. Education, fire prevention, and public health offer examples. So do policing and regulation, though broader considerations also apply to them. Resources produce more total benefits than if used privately. Factors of production have higher marginal productivity, all outputs considered, in government than in private use.

A variant of the same argument is familiar to economists. If an industry produces under conditions of decreasing cost, government operation (or subsidy) can permit larger total volume and lower unit cost than private operation (without subsidy). If government pays the costs by taxes that reduce private (and government) outlays on constant or increasing cost industries, the community's total real income will be enlarged by the shift of resources.[2]). The use of compulsion to modify the allocation of resources may thus improve upon freedom, judging by the criterion of output per unit of input.[3]).

Rarely will one find an economist who denies the validity of the principle that the public can obtain larger real income by using government for some functions than by relying exclusively upon private, free markets. Yet by its very nature the principle is deficient. As the world actually functions, the additional benefits are not measured, or at least not fully. Often they cannot be measured. Even the order of magnitude may be uncertain. Sometimes the social benefits cannot even be identified.[4]).

There seems to be little hope of overcoming this inherent difficulty of measuring social benefit. (In fact, as indicated, I see some reason for believing that the principle will be used erroneously, in opposing directions — to indicate too great and too small outlays). Some progress must be possible, however. Help will come from more precision in thinking, sharper definition of the claims made, greater effort to measure where, and to the extent that, measurement seems

[2]) For a valuable analysis based upon distinction between government ends and private ends see E. R. Rolph, *The Theory of Fiscal Economics* (Univ. of California Press, Berkeley, 1954), Ch. 3.

[3]) The compulson itself involves costs, a deprivation of freedom. The larger real income, however, increases opportunities; in this sense it enlarges freedom. The individuals affected in the two ways may not be the same. In such cases problems of inter-individual comparisons of utility arise.

[4]) Spending to *prevent* undesired developments is an example. Such spending yields results which are exceptionally difficult to measure and perhaps even to discover. A federal state will encounter a special form of the problem of identifying results; there may be significant difference in the geographic location of those who pay and those who benefit directly, and the former may gain only by a very indirect process.

possible. So, perhaps, can help come from greater caution in writing and teaching, to avoid giving the impression that society — or its "intelligentsia" — has a quide that is better than in fact is the case. Policing and national defense yield general social benefits and serve a different kind of public interest than, say, free hospitals or subsidies for farmers. Or do they?

Even if, and when, better measurement is possible, there is no certainty that it will be accomplished or that it will play a decisive role in making decisions. Here the economist enters the domain of politics. Though he may stop at the boundary, he owes those whom he addresses this clear warning: One cannot safely assume that the possible will be achieved in making political decisions, that best economic guidance will be sought and followed.

Two more measurement problems can be indicated briefly.

Private activity may create benefits for which it is not compensated. [5]). New housing that improves an area, a scientific discovery that makes police work more effective, added utility investment that permits lower costs for other industries and greater efficiency, these are three examples. The fact that businesses may not take such matters into account in their planning gives strong presumption for the belief that from the public point of view these results will not get the weighting they deserve. Their measurement presents the same difficulties that arise in trying to measure the intangible or non-marketed results of government activity. To some extent government may be able to use its power of compulsion to get businesses to seek such objectives. [6]). Zoning and building codes present examples. If the achievement is costly, government compulsion may still produce results, though the ability of firms to recoup through prices (or reduced earnings) will set some limits. (These limits may give a little indication of the worth of some of the results to the public, but at best very incompletely). The public has powers of government other than those of spending to get what the free market would not provide. Measurement of the economic costs and benefits of the alternatives open to the public through government becomes complicated indeed!

Another serious measurement difficulty arises from financing through tax payments. Taxes withdraw resources from individuals and businesses with a variety of effects. (Some of the effects tend

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[5]) Private businesses, we are often reminded, need not pay for all the costs their activity involves — polution of air and water remains a good example. Yet neither do government pay for all the costs incurred in performing their activities.

[6]) This possibility touches on issues I have raised elsewhere. See C. Lowell Harriss, "Government Expenditure: Significant Issues of Definition", *Journal of Finance*, Dec. 1954, pp. 351—640.

to defeat the purposes of spending programs). One aspect of the effect of taxes that complicates measurement is my concern here.

Taxes do more than just absorb resources as do prices. Taxes produce different secondary effects from prices. The payment of a tax, unlike the payment of a price, brings no *quid pro quo*. The payer does not himself lose a government service if he fails to pay the tax, whereas he will not get a product sold in the market unless he pays its price. Consequently, he has a different kind of incentive to avoid or evade tax payments from the incentive he has to escape prices.

When tax rates were much lower than totay, this difference between taxes and prices could generally be ignored without risk of serious error. Now, however, some tax rates are high enough to require the most complete consideration. At the margin, or at many margins, tax funds to pay for government spending may (have to) come from rates that are high enough to cause "distortion" of decisions of many types. Individuals and businesses do not do what would be to their best interests if taxes were not escapable. In other words, the opportunity to escape taxes leads to decisions which otherwise would be second, third, or still lower choices. Private and public interest diverge. Choices are made that divert resources from what would be their best uses. The private sector of the economy must then bear costs in addition to those of the taxes collected. [7]). Speculations about the nature of such results are numerous, but the amounts — and even the orders of magnitude — remain a mystery.

The mystery can never be solved completely. The areas of uncertainty will be large. [8]). Great doubt will remain in identifying "distortions" and then estimating their significance.

Quality of Government Employees and the Environment for their Operation.

The wisdom of using government spending to achieve an objective will depend upon the quality of personnel — and the type of organization — available in government. [9]). Sometimes the relevant

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[7]) If the private spending that is cut by taxes were concentrated on output of decreasing cost industries, the resulting losses would be still more serious. But there is no presumption that this outcome would be probable.

[8]) The effects may appear worse than facts would justify. Resources *must* be taken for public purposes; the deprivation of private firms and individuals of what they would otherwise keep will appear bad to them. In fact, however, this deprivation is desirable (except in periods of depression) if the spending is to be done. The measurement of the badness of the effects is more complex than seems on the surface.

[9]) The same applies to attempts at more or less intensive or extensive accomplishment of a function already being performed.

issue is the comparison of these features of government with the corresponding features of alternative agencies, private business or other voluntary associations.

People do things. [10]). Though we often speak, and even think, of "government" or a corporation acting, what is done is done by human beigns. Accomplishment, then, depends significantly upon the people who do the work and the conditions under which they operate. (Moreover, in comparing government with the private economy, one must consider the relative merits of (a) those who collect the taxes with those who would collect in prices for business and (b) the system of charging prices with that of tax collection). "Quality" of personnel is not easily defined, and certainly not measured; but it includes, among other things, technical competence, good will (including integrity), and industry.

Part of the preference of Adam Smith and many others for the market over government can be explained by the unattractive quality of government officials with whom they were familiar. The contrast in attitude of many economists in the last few decades can be understood better by recognizing that the character of the civil service has changed and with it the instrument of government. Much of the change has been improvement. Moreover, the extension of power to vote doubtless accounts for some of the increase in willingness to use the state; elected officials will presumably represent the public as a whole more adequately, and the public will trust them more fully to direct a larger portion of resource use, when the franchise is broad.

Conditions today vary from place to place. It is my impression that some observers in underdeveloped lands look to government because of dissatisfaction with business leadership. Whether government officials are more competent for the jobs about which there may be a government-business choice will not always be easily determined. Generalizations about the characteristics of bureaucracy and of business and businessmen may be helpful, but their generality may mislead.

For best guidance of decisions on specific problems — this particular function, here, now — analysis of facts in the specific situations must be made as well as possible. Can we get some indication of the intellectual ability and training of new recruits to the civil service? Can we judge the extent of competitive or other pressures on business personnel to act in the best public interest (determined how?)? What are the procedures within government for bettering operating methods? What are the strengths and the weaknesses

[10]) Nature also does things, but otherwise what happens results from human actions, by individuals acting alone or in groups.

of different types of government and private organization? Would the change in the total load assigned to government officials alter their ability to do the most important work of government as well as it "should" be done?

Questions such as these must be faced if the best possible decisions are to be made. The obstacles to good answers are substantial, of course. Honest debate still flourishes over private versus government efficiency in utility operation. Careful and deliberate study will help, however. Even posing the question may assist in avoiding some errors — romantic notions of the wisdom, impartiality, and power of civil servants and politicians, or the practical freedom and perfection of markets.

Yet the degree to which government expenditure relies upon execution by government personnel is not fixed. During World War II, and to a lesser extent since then, the U. S. government has engaged private businesses to operate government facilities, including some of the greatest importance, such as atomic energy installations. The willingness of private corporations to undertake what has at times been a heavy responsibility for little or no compensation can be explained in part by patriotism. I have no competence for judging whether in such cases businesses succeed in bringing to government operations the bulk of advantages of organization developed to earn profit. Nor can I judge how much further this interesting technique might be extended.

A more familiar example of how the influence of government can extend far beyond its spending may be noted in passing. Regulation of various sorts can modify profoundly the functioning of private businesses. If done well, it can achieve benefits associated distinctly with government, namely those from use of government power of compulsion and coercion, but by forcing or channelling private spending rather than by taxing and government outlay. The demands on government personnel and organization are only a small fraction of those required if government were to perform the function itself.

Limits on Government Spending

Discussion of the quality of government personnel raises another issue. Perhaps there is some point, or range, beyond which reliance upon government brings decreasing returns (absolutely or per dollar spent). For one thing, taxable capacity may be limited. I shall not try to consider this possibility here, however, except to say that even if it has validity it does not necessarily limit government spending — governments can use prices as well as taxes.[11]). I do want

[11]) Prices will hardly serve to finance transfer payments. In this respect, as

to comment on two other limiting factors which may be relevant.

One is the ability of government to attract personnel of adequate quality, to pay the salary rates needed.[12]). Government service has features which may positively attract some persons, repel others, and be a matter of indifference to still others. If the public were really willing, if it would make the sacrifices necessary, I have no doubt that it could recruit the staff needed for good execution of a spending program of larger scope than found anywhere in the Western world. Yet in real life, the compensation and other features of government service may not adapt to a growing, or even stable, scope of government spending. If so, there may in a meaningful sense be limits to what the economy can get (efficiently and effectively) through government. Competition will provide limits. In broad terms, persons of high capacity will produce enough if employed privately for business to be able to pay higher compensation than governments will pay. The baffling doubt about how to appraise quality of government accomplisment will make us unsure of apparent conclusions. The unwillingness to spend in certain ways limits the possibility of achievement in others.

Another kind of limit is the time and interest of the public and its elected representatives. A public that relies upon the political, rather than the market, process for ultimate control must recognize the problems of political control. One is that the interest span of the general public is limited. So is its competence. The same applies to political leaders and top civil servants. The greater the number of problems, the less the chance that each will receive the attention required for its best solution. And, I think, the greater the chance that a decision will be made less competently than if it were one of a smaller group, other things the same.[13]). What is involved may be an issue truly applying to the whole public — national defense research or diplomacy. Or it may involve many but not all. Or it may not be essentially a matter of government. Some people decide for others. At this point we reach the question of freedom versus compulsion, one which would take us into more frequently

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in others, the character of spending bears upon the validity of the thesis that there is a limit to taxable capacity.

[12]) Admittedly, this point is a variant of a broader one — failure to spend enough to accomplish an objective. It focuses on a significant part of the whole — personnel and their rates of pay. In buying materials in the market, government must pay the prevailing price. Human services, however, vary greatly in quality. Their purchase is not only more or less of a homogenious product of some clear type — such as cement — but of different things.

[13]) This point is the basis of one argument against large size in business or any organization. Various devices, including staff work and many kinds of mechanical aids, increase the ability to handle more problems.

debated territory. For present purposes, it is enough to see that restrictions on the time and effort of those who decide issues of government policy create a kind of limit on what can be accomplished. Let us look a bit more at the making of decisions.

Rationality of the Decision-Making Process

The factors affecting the making of decisions must influence the quality of those decisions. Although I find difficulty in even conceiving complete rationality, greater rather than lesser rationality seems not only meaningful but important. The importance will depend upon the amounts involved. Today some government spending decisions involve amounts that are large enough to justify the utmost effort at rationality.[14]). Many factors, some already noted, influence the public's ability to make rational choices about government spending. A few more aspects of the problem may call for discussion, not so much for their novelty as for their bearing upon this less familiar issue.

1. The first is the fact that decisions to spend and to finance the spending are sometimes separated and widely separated, more widely than in the private economy.[15]). This separation does not necessarily encourage the best judgment of spending. Many who make decisions to spend government funds may feel — correctly or not — that they themselves will bear little or none of the cost. They may be private citizens or government officials, seeking perhaps the most enlightened or humane of results, predominantly or exclusively for others. They may be low income groups who believe that costs can be placed upon persons who are more prosperous. On occasion it may appear to those influential in making spending decisions that funds can come from other areas or groups. In all such cases the probable result, the one to be expected, is "excessive" allocation of resources to the government activity. For spending, whether using or transferring resources, can do wonderful things! Focus on these good things without full thought for costs will certainly bias judgment and results.

2. More clearly, when the determining decision-making lies with those who believe they can get for themselves benefits from expenditure greater than the costs they must bear, the total use of resources must be greater than if careful balancing of benefit and

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[14]) It is not only in young students that I sense at times a feeling that because government is big, powerful, undying it is also rational, far more rational than mortal individuals.

[15]) Perhaps a person on an expense account is in a somewhat comparable position, or, to lesser degree, one buying on "easy" terms.

cost were required.[16]). 2a. Such results are encouraged by the common attitude that it is "all right" to take from government. A person who would never consider theft, who would be revolted by the news that a government official had used his position for personal financial gain, may have no compunctions about using the power of government legally to force others to benefit him. Competition, even characterized by the limitations so familiar today, provides checks in the private economy which are not to be found at the level of national or state government, nor even at the local level. 2b. The success of one interest group in getting favors from government induces others, in a sort of self-defense, to seek benefits, often through public spending.

3. Sometimes, I feel, extreme cases carry undue weight when decisions about government spending (or taxation) are involved. The state acts for everyone. The extremes are included. Their interests must be taken into account, along with the interests of the vast majority in between. Yet how? In a significant sense this is a job the market does not need to face. Most of us are glad that some agencies — private philanthropy and government — stand ready to do some things the market fails to do. Yet when government policy is being made, we may not know how to take proper account of extreme cases. Exceptions may be treated as if they were the rule. A small minority of cases may provide the "justification" for a program which includes many who are different indeed from the cases that provide the emotional impetus. Welfare and social insurance programs not based on need, farm aid and free schools offer possible examples. One resulting tendency is less efficiency, less rationality, in resource allocation.

4. Decisions to spend are sometimes made on the assumption that they are temporary. A program starts with at least some of those who provide the support believing that it will not last indefinitely. When it is established, however, stronger forces for continuation appear. The original assumption that the undertaking is temporary reduces somewhat the rationality with which the total set of decisions is made. In this reason, again, we find support for the general point of this section — that the process of deciding on government spending has features which lead to less wise, less well balanced judgment than would be desirable. 4a. Closely related is the fact that some expenditure programs are started at a "low" level of outlay but one which in fact involves commitment to much

[16]) I recognize that money measures of benefits are exceptionally difficult — often impossible — where government services are involved. It is even harder when transfers are at issue. Yet freedom from the pressures to try to compare gains and costs cannot improve the process.

greater outlays. The total commitment may be understood accurately. It may not. In the latter case there is lacking an essential requirement for making the decision that best reflects the true and full preferences of the public.

5. Moreover, the public at one time can bind its successors, morally and legally. Incurring debt, earmarking revenues for specific expenditures, a schedule of aid for veterans, and other decisions have effects more far-reaching than must be weighed when they are made. Even when the decision is made most carefully, it cannot fully consider the facts that pertain to the conditions to which it will apply. Business firms and individuals, of course, also make decisions for the future. Competition and changing conditions, however, operate in the private economy, in ways that force adaptation. Past spending commitments are less binding than in government.

6. The hand of the past has a less familiar effect on current government spending. The resistance to cutting or abandoning established programs is strong. When money is not plentiful, the standard situation, there may be difficulty adding programs which in fact might be accepted as superior to those in operation. The pressure to retain the old is so great that no objective balancing of new and old is possible. The discontinuities are so large that nothing like marginal adjustment on the merits of the cases is even remotely possible.

7. The influence of pressure groups adds other forces that may "distort" the use of resources through government spending. Many such groups are organized to achieve objectives which, though often meritorious, are narrow relative to the whole range of possible objectives. Not all interests are represented by groups of equal power. Moreover, groups need not be concerned with specific revenue measures to be used to finance the added spending they seek. The pattern of government spending, and perhaps the total amount, can be influenced decidedly by the weight of groups which are inclined to forget competing interests, and perhaps even to neglect cost. 7a. Pressure groups are not all organized to increase spending. Some are concerned with taxes. They may — in fact they sometimes do — ignore the good effects of spending in their search for ways to impress the importance of actions to cut taxes. Perhaps they act out of sheer ignorance, perhaps from informed but deliberate decision to press a biased case. In either event, to the extent that they succeed in adding to awareness of the bad effects of taxes without corresponding concern for benefits of spending, they, too, tend to induce a "distorted" result. The distortion of the decision-making process may be not only for an unduly low level of spending but

for a poor balance. More of the deficiency may be concentrated on some types of spending than on others, by accident and in some cases, perhaps, design.

8. Another consideration that affects decision-making is the competition from private business. Private sellers are in a sense rivals of government for the public's spending power. Businesses in trying to get consumer dollars can advertise and use various types of selling appeal. The corresponding public interest is not assured of equal pressure. There is no profit motive, as a rule, in persuading the public to buy more of some government service. Yet in the United States it is certainly true that the skill of modern advertising and publicity has been devoted to induce more spending on schools, highways, and occasionally some other type of government activity. Vastly more such effort, however, is directed toward persuading consumers to buy this or that product of business. The money spent in response is not available for payment for things that might be bought through government or for transfers. Thus, spending on autos rises out of proportion to spending on parking space. Business creates forces that bias our attitudes: indirectly and unconsciously we are persuaded to use our income in ways that profit business rather than buy government services. The public cannot be truly neutral or free in deciding how to spend its income.

9. Sometimes the control of information hinders good decision making on questions of government spending. I am referring not to the lack of facts, to the not infrequent failure of government to assemble the information that would help evaluate accomplishments and opportunities. My point here is less familiar. The public cannot always get from public officials all the data that might throw light on a problem. Perhaps instances of withheld information are exeptional. One will certainly be impressed at the mass of revealing data and analysis sometimes presented, for example, during various stages of the budget process. Yet considerations of national defense and diplomacy require that some information be withheld. Less justifiable is the decision by officials to keep under cover facts that may not support a department's case. Legislative persistence may succeed in forcing more disclosure than the executive wishes — during question period in the British Parliament or at Congressional hearings in the United States. Success, however, is by no means complete. At state and local levels conditions will vary widely. Sometimes concealment is impossible, sometimes easy. No one can know how much information that bears upon spending decisions never leaves agency files. Certainly it is too much. Official control of facts can hardly be neutral. Agencies are not. They will tend to select and present data that do not weaken the position they

have taken. The public is at a disadvantage. But it is not helpless. Academic and other nongovernmental research groups provide help and would provide more if the demand were evident.

Sensitivity of Spending to Changing Conditions.[17]).

Activities financed by government expenditure are free from important tests of the market. Shifting preferences are reflected less quickly and less completely in demands for government services provided from tax funds than for products of the market. The test of profit and loss is not ideal — one reason we use government is to escape it. Yet among the useful services the profit-loss test performs are (a) giving indications of changes in preferences and (b) taking resources away from uses less urgently desired and directing them where the wishes of buyers and sellers (to the extent valued in the market) are being well satisfied. When there is inertia in government spending — and there is much indeed, both in totals and in the balance among functions — some loss of public welfare through delay in adjustment is to be expected.

The modern world is one of change. As a result, the following presumption seems correct: Where there is choice, we should keep in mind the somewhat low sensitivity of government spending to changes in conditions. The job we face in using the political process includes the challenge of finding ways to help ourselves later stay up to date.

Income Growth and Government Spending.

As an economy grows more productive, as per capita real income rises, is there "need" for more or for less government spending? Strong arguments run in opposite directions.

On the one hand, the ability of the economy to devote resources to government financed activities increases. Poverty becomes less of a limiting factor. Society can enjoy more and better government services — police, defense, schools, parks. Society can also make more of the transfers which, on humanitarian or other grounds, have strong appeal. On the other hand, some needs fall. The public, or more of the public, is better able to provide its needs through the market. More of the things people want seriously enough to pay for can be provided by businesses operating in relatively free markets, without the compulsion of taxes. The need for welfare and similar transfer expenditures must presumably drop, while the ability to make contributions freely rises.[18]).

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[17]) This section somewhat duplicates points made earlier. Its importance seems great enough to justify some repetition.

[18]) Although standards of welfare will rise, beyond some level they can be

One significant result of rising income would be greater opportunity to use *prices instead of taxes* to finance government spending. The economy, of cource, is better able to pay taxes; yet it is also better able to pay prices. Prices may be preferable to taxes in more than one way. In some situations they offer greater freedom; the compulsion to pay is less; the opportunity of alternative sources provided privately can be greater. Whether the opportunity is in fact greater will depend not only upon the government's pricing policy but also upon its willingness to permit private suppliers. If the government has a monopoly, either by law (the postal service in the United States) or because the activity is truly one of natural monopoly (decreasing cost), the freedom of alternative sources is hardly significant. If more costs of elementary and secondary schooling were paid for by charges on the user, as in state universities, the practical freedom of parents to select private schools (and to seek better quality of schooling) would be increased. Another aspect of prices as contrasted with taxation is that prices may serve usefully to restrict the quantity of service demanded. Some, but by no means all, of the services provided through government, we want to be used without restriction resulting from the individual's desire to save by not using. Other services however, must be economized; and prices may help induce such economizing.

Final Comment

Several attempts over a period of years to work on aspects of government spending have added to my respect for the difficulties involved. The traditional preference of students of public finance for problems of taxation is more easily understood, I think, the more one tries to study the economics of public spending. The comments in this paper touch upon an assortment of problems. Few, if any, lend themselves to incorporation in formal economic theory of the traditional type. Yet in less formal, but certainly no less important, theory, in the thinking of economists on problems of not inconsiderable significance, the issues raised here ought to have a place. No neat, complete solutions are likely. Yet our results are likely to be better if, instead of "assuming away" these (and other) problems, we recognize them and push the investigation for their solution.

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expected to create more than negligible conflicts with the needs for incentives. Other things the same, the number of claimants with truly justifying demands for aid must decline.

DEPENSES GOUVERNEMENTALES: THEORIE ET PRATIQUE

par le Professeur C. Lowell Harriss

RÉSUMÉ

Une des causes économiques qui amènent le public à se servir du gouvernement plutôt que d'autres organisations, pour atteindre ses buts, est le fait que certaines opérations produisent de plus grands avantages sociaux que d'autres. Les entreprises privées ne peuvent récupérer que la valeur des services vendables qu'elles rendent et ceux-ci peuvent ne pas comprendre toutes les valeurs importantes. Pourtant les valeurs sociales ne peuvent guère être mesurées assez exactement pourqu'elles fournissent une indication sûre pour les dépenses du gouvernement. Il n'y a pas assez de certitude à supposer que des décisions politiques réfléchissent en effet les meilleures directives économiques. Deux autres problèmes de mesure se présentent: les opérations commerciales peuvent aussi produire de bons résultats non-vendables et les opérations gouvernementales peuvent en produire de mauvais! les impôts peuvent avoir des effets économiques indirects défavorables.

La qualité du personnel du gouvernement et l'entourage dans lequel il doit travailler, en comparaison avec d'autres organisations, devrait influencer les décisions concernant les dépenses à faire par le gouvernement. Ces décisions varieront de période à période et de pays à pays. Est-ce que le service du gouvernement attire peu ou beaucoup de gens de qualité supérieure? Quelles sont leurs conditions de travail comparées à celles dans une entreprise privée qui pourrait effectuer une opération? La compensation que reçoivent les fonctionnaires du gouvernement et l'intérêt que le public porte aux affaires politiques tendront à déterminer les limites, non-mesurables, de ce qui peut être réalisé à l'aide des dépenses du gouvernement.

Plusieurs facteurs influencent la rationalité avec laquelle sont faites les décisions en ce qui concerne les dépenses du gouvernement. Le fait qu'on sépare ordinairement les considérations à la base des dépenses d'une part et celles gouvernant la levée des revenus du gouvernement d'autre part porte à croire que l'allocation des fonds qui en résulte est défective.

En outre, l'opinion de quelques-uns qui croient qu'ils peuvent obtenir des bénéfices à partir de dépenses sans toutefois payer eux-mêmes tous les frais, et l'idée généralement repandue qu'il est propre

d'utiliser la coercition du gouvernement pour rédistribuer les revenus, mènent probablement à des dépenses gouvernementales qui, au total, sont plus grandes qu'il ne serait justifié de faire sur des bases économiques. Comme le gouvernement n'exclut personne, les intérêts des cas extrêmes doivent être considérés; pourtant ces intérêts sont difficiles à estimer à leur valeur exacte. On peut commencer l'exécution d'un programme de dépenses dans l'idée qu'il est temporaire ou que le niveau „bas" du commencement se maintiendra. Cependant, une fois que l'exécution de ce programme a commencé le public constate qu'il est difficile de le terminer ou même d'en prévenir l'accroissement et cela davantage que de réduire les achats d'un article sur le marché. En effet, des engagements faits à un certain temps réduisent plus tard la liberté du public d'agir aussi rationnellement qu'il pourrait dans les conditions changées. Des „groupes de pression" de plusieurs espèces stimulent et empêchent à la fois un jugement sage des dépenses du gouvernement. La concurrence des entreprises privées pour s'attirer le pouvoir d'achat des consommateurs, concurrence qui se manifeste dans les efforts des entreprises de vendre leurs articles, peut influencer le jugement du public des mérites relatifs de l'application de fonds par des institutions privées et par le gouvernement. Enfin, des renseignements complets sur les activités du gouvernement ne sont pas toujours disponibles au public.

Il est très difficile d'adapter les programmes de dépenses à des conditions qui changent, partiellement parce qu'il n'y a rien de comparable aux comptes de profits et pertes des entreprises privées. A mesure que le revenue par tête de la population augmente il y aura occasion d'étendre les dépenses gouvernementales mais le besoin en est peut-être moins grand; une des possibilités est alors de financer les dépenses du gouvernement à partir des prix plutôt que des impôts. Pour tous les aspects du problème des dépenses du gouvernement nous avons besoin de plus de réflection et de meilleurs renseignements.

QUELQUES ASPECTS ECONOMIQUES DE LA TAXE FRANCAISE SUR LA VALEUR AJOUTEE

par CHARLES CAMPET, *Paris*

La projection des différentes conceptions économiques sur le terrain fiscal a déterminé des conceptions correspondantes de l'impôt.

Si l'on groupe grossièrement en deux tendances, que l'on peut désigner par les termes généraux de socialisme et de libéralisme, les courants économiques du XIXème siècle, chacune de ces deux tendances a donné sa définition de l'impôt correspondant à sa philosophie.

Pour les libéraux, l'impôt est uniquement le moyen de couvrir les dépenses de fonctionnement de l'Etat, dépenses qui au surplus doivent être aussi réduites que possible, les fonctions dévolues à la puissance publique étant des plus limitées. En tout état de cause, l'Etat n'ayant à peu près rien à voir avec l'organisation économique, qui relève en principe de l'entreprise, l'impôt ne saurait avoir aucun but autre que celui de procurer les ressources publiques indispensables. Ses qualités doivent être recherchées surtout dans la simplicité de son assiette, et le faible coût de son recouvrement.

Pour les socialistes, l'impôt, outre sa fonction de procurer des ressources à l'Etat, doit remplir une fonction de redistribution du revenu.

Ce schéma a certes évolué; il est devenu plus complexe; mais les deux conceptions fondamentales du rôle de l'impôt y conservent leurs racines. L'une fait de l'impôt un instrument économique, l'autre au contraire veut le limiter à son rôle purement fiscal, et lui conserver une „neutralité économique".

L'expression de „neutralité économique de l'impôt" ne doit du reste pas être entendue, comme il semble qu'elle l'ait été quelquefois, comme signifiant que l'impôt ne doit pas avoir de répercussions économiques. [1])

En effet, l'impôt constitue en soi un phénomène économique: un prélèvement fiscal nouveau introduit, de quelque manière que ce soit, dans un système économique en équilibre, trouble nécessairement, par le seul fait de son introduction, cet équilibre; il se produira ensuite un nouvel équilibre, mais dans lequel les rapports

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[1]) Cf. à ce sujet notamment François Visine — La signification des statistiques fiscales et leur utilisation; in Public Finance no. 1, 1955, p. 12.

respectifs des éléments du système ne seront plus les mêmes. Prétendre introduire un impôt qui n'apporte aucune perturbation dans les structures économiques, reviendrait à prétendre lancer un caillou dans une flaque d'eau sans provoquer d'ondes de choc.

Par contre, on peut envisager d'essayer de procéder à un calcul préalable des effets économiques de l'impôt.

Dans la conception interventionniste, ces calculs préalables permettront de déterminer la forme d'impôt qui permettra d'influer sur l'économie en conformité du plan.

Dans la conception dite neutraliste, ils permettront de déterminer la forme d'impôt qui apportera le moins de perturbations possibles aux structures économiques préalables, les modifications qui pourraient éventuellementt être apportées à ces structures, ne devant, en tout état de cause, pas être provoquées par l'impôt.

On peut alors définir un impôt neutre comme celui qui, tout en modifiant (ce qui est inévitable) les données numériques du milieu économique considéré, *n'apporterait pas de changements aux rapports respectifs de ces données.*

Or, quelle que soit la philosophie politique à laquelle on s'arrête, il est un domaine où le respect de cette „neutralité" ainsi conçue, paraît essentiel, en matière de taxation indirecte: c'est celui des investissements. Que l'on adopte en effet le principe hédonistique des classiques, qui recherche l'obtention du maximum de satisfactions pour le minimum d'efforts, ou le principe du progrès socialiste, dont le but est la libération du travailleur, c'est vers la mécanisation, le remplacement de l'homme par la machine, que l'on doit tendre. Une fiscalité indirecte qui aurait pour conséquence de frapper l'investissement, c'est-à-dire les biens intermédiaires de production, quels qu'ils soient, serait donc un non-sens. Sans doute, certains investissements sont-ils plus ou moins utiles; mais, comme nous aurons l'occasion de le dire plus loin, il existe pour diriger les investissements d'autres procédés que celui qui consiste à en pénaliser certains: frapper par un impôt indirect un investissement, sous le prétexte que la production à laquelle il concourt n'est pas indispensable, revient à *accroître l'effort humain* nécessaire à cette production, donc à aller à l'encontre du principe hédonistique aussi bien que du progrès socialiste; on peut en revanche soit supprimer autoritairement cette production, soit la décourager par le biais d'une taxe indirecte *frappant le produit final de consommation* (taxe de luxe), soit la contenir par tout autre procédé. L'essentiel est de ne pas pénaliser l'investissement en soi.

Il est essentiel de rappeler que c'est dans cette optique que doit être envisagée une taxe sur la valeur ajoutée.

Elle est conçue en effet comme destinée à n'apporter aucune

perturbation aux rapports respectifs des données économiques, ni à pénaliser les investissements. De cette constatation, découlent deux séries de conséquences:

a) on ne saurait lui faire grief de frapper d'une manière uniforme, par exemple les diverses formes d'entreprises, ou les diverses activités industrielles, ou les différents moyens de production (main-d'oeuvre et machines), puisque précisément son but est cette uniformité;

b) on ne saurait non plus essayer de l'utiliser comme un instrument d'interventionnisme économique.

A la lumière de ces observations préliminaires, et après avoir rappelé la définition de la taxe sur la valeur ajoutée, nous exposerons la structure actuelle du système français, et nous tâcherons ensuite de la confronter avec un système idéal de T.V.A., afin de dégager les différences qui l'en séparent.

Comme son nom l'indique, la taxe sur la valeur ajoutée est un impôt dont l'assiette est constituée par la „valeur ajoutée" à un produit, à chacun des stades de sa fabrication. Un tel système comprend donc, pour chaque produit taxé, une série de perceptions partielles, effectuées à chacun des stades du circuit de fabrication et de commercialisation, jusqu'au moment où le produit parvient à l'utilisateur final ou au consommateur: à ce moment, le produit a supporté la taxe, par addition des perceptions partielles, sur la totalité de sa valeur, ou plus exactement sur son prix de vente au consommateur.

Donc, il s'agit, suivant la terminologie fiscale française, d'une part d'une taxe unique, c'est-à-dire qui n'atteint le produit qu'une fois; et d'autre part, d'une taxe générale, puisqu'elle est destinée à atteindre tous les produits. C'est enfin une taxe à payements fractionnés, puisque, bien qu'elle ne frappe le produit qu'une fois, sa perception est échelonnée tout au long du circuit de production et de commercialisation.

La détermination de la valeur ajoutée peut se faire de deux façons.

Pour un produit déterminé, et pour un certain stade de sa fabrication par exemple, on peut concevoir une détermination de la valeur ajoutée à ce stade, à partir d'une analyse des différents éléments apportés au produit par l'intermédiaire considéré, dont il suffirait ensuite de faire l'addition.

On voit immédiatement les difficultés d'une telle méthode. Certains éléments dont la valeur est finalement, au moins partiellement, intégrée dans le prix de revient du produit, ne peuvent être calculés immédiatement, mais seulement quelquefois en fin d'exer-

cice. Cette méthode tendrait finalement à une determination comptable quelque peu analogue à celle d'un bénéfice brut. En quelque sorte, elle aurait tendance à déterminer une valeur ajoutée au niveau de l'entreprise, et non plus au niveau du produit.

Une seconde méthode consiste à procéder par soustraction entre la valeur du produit à la sortie du stade considéré, et sa valeur à l'entrée. Plus généralement, la valeur ajoutée taxable sera constituée en fait par la valeur de sortie diminuée de la valeur de chacun des éléments *ayant déjà supporté la taxe*.

Cette seconde méthode est moins satisfaisante pour l'esprit que la première; mais elle n'en présente ni les complexités, ni les dangers.

Elle est en effet beaucoup plus simple, puisqu'elle n'exige aucune analyse à chacun des stades successifs; et d'autre part, elle permet beaucoup plus sûrement de rester au niveau du produit. [2])

Il faut noter par ailleurs que l'analyse micro-économique de la valeur ajoutée conduit à prendre en considération dans le décompte des divers éléments qui la constituent, le montant des amortissements des investissements, tandis que la seconde méthode tient compte du montant des investissements eux-mêmes. Mais il est évident, que du point de vue fiscal, le résultat, réparti sur un certain nombre d'années, est le même dans les deux cas.

Une taxe répondant à la définition ci-dessus donnée n'apportera pas de perturbations dans les conditions économiques préalables, et spécialement dans les conditions de la concurrence. En effet, tous les produits seront uniformément taxés, quelle que soit la longueur des circuits; par ailleurs, les biens intermédiaires de production (matériels, machines, etc...) ayant déjà supporté la taxe au cours de leur processus de fabrication et de vente, leur coût ne saurait constituer un élément de la valeur ajoutée au produit par l'entrepreneur qui les utilise; ils ne sont donc pas frappés à nouveau et viennent à égalité de taxation avec la main-d'oeuvre.

Il n'est pas inutile de souligner, enfin, combien un tel système s'inscrit dans le cadre de la pensée keynésienne originale.

En effet, l'action économique de l'Etat préconisée par Keynes est une action globale: elle respecte la liberté économique individuelle dans les seules limites dégagées par cette action globale.

En ce qui concerne l'investissement, la manipulation du taux de l'intérêt fonctionne à la manière d'un robinet; mais les entrepreneurs restent maîtres d'investir de telle ou telle manière.

En ce qui concerne la consommation, les ponctions effectuées

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2) Cf. Gunther Schmölders, die Veredelung der Umsatzsteuer, in Public Finance, 1954, no. 2.

sur les revenus par l'impôt modifient la propension à consommer, mais il appartient aux particuliers d'organiser l'emploi de leurs ressources.

Or, la taxe sur la valeur ajoutée, d'une part respecte les calculs économiques des producteurs et des consommateurs, et d'autre part est indépendante des moyens d'action de l'Etat: taux de l'intérêt, et impôts sur les revenus.

I. *L'application de la T.V.A. en France*

La T.V.A. n'a pas été introduite en France par remplacement pur et simple du système ancien par un nouveau. Son application en réalité est le fruit d'un processus historique, qu'il suffit de rappeler brièvement pour expliquer la conception française.

En 1936, fut instituée, en remplacement du système d'imposition des affaires jusque là en vigueur, et qui comprenait un nombre important de taxes uniques, dont chacune atteignait une catégorie déterminée de produits, une taxe unique générale, c'est-à-dire une taxe perçue sur tous les produits, mais une seule fois sur chacun d'eux. Il fut décidé par ailleurs qu'elle atteindrait le produit à l'issue du circuit de production, lorsqu'il passe au circuit de commercialisation: ce fut la taxe à la production dont le taux supporta assez facilement des augmentations successives.

La taxe était donc perçue, pour chaque produit, à un point déterminé de son circuit: après le payement, le produit était définitivement hors du champ de la taxe; avant ce payement, les matières entrant dans la fabrication du produit étaient provisoirement exonérées: c'était le régime dit „de suspension de taxe".

En 1948, ce régime dit „de suspension de taxe" fut remplacé par le régime dit des „payements fractionnés". Au lieu d'être perçue en une seule fois, à un point déterminé du circuit suivi par le produit, la taxe fut perçue dorénavant par fractions successives, à chacun des stades de ce circuit. Dans un circuit ainsi constitué: matières premières → produit semi-fini → produit fini → grossiste → détaillant, la taxe était perçue, dans le système de suspension de taxe, en totalité au stade du produit fini, lors de la livraison au grossiste. Dans le système des payements fractionnés, le vendeur de matières premières acquitte la taxe sur son prix de vente; puis le vendeur du produit semi-fini l'acquitte également, mais en en déduisant la taxe supportée par les matières premières; enfin, le vendeur du produit fini procède de même; de sorte qu'à ce stade, comme dans le système précédent, le produit a supporté la taxe sur son entière valeur de production.

A partir de ce moment, la taxe sur la valeur ajoutée était contenue en puissance dans la législation française.

La différence principale qui séparait encore ce système de celui d'une taxe sur la valeur ajoutée, provenait du fait que l'on s'était seulement basé, jusqu'alors, dans l'organisation du jeu des déductions successives de taxe, sur le processus physique de la fabrication: les déductions ne portaient en principe que sur les diverses matières physiquement intégrées dans le produit. L'assiette de la taxe était donc sensiblement différente, plus exactement sensiblement plus large que celle d'une taxe sur la valeur ajoutée: elle correspondait en effet à la différence entre le prix de vente du produit au stade considéré, et le coût des matières physiquement intégrées au produit à ce stade. Or, le prix de vente du produit au stade considéré, comprend en réalité, outre d'une part les matières physiquement intégrées, et déjà taxées, et d'autre part le coût de la main-d'oeuvre et la marge bénéficiaire qui n'ont pas encore supporté la taxe, plusieurs autres postes c'est-à-dire essentiellement les amortissements des investissements, les frais généraux et les prestations de services.

Mais ces autres postes ont eux aussi déjà supporté la taxe, lors de l'acquisition des biens (matériels industriels, frais de bureau), ou de la prestation des services (banques, transports). Le système de 1948 aboutissait donc à une double taxation de certains des éléments du coût du produit; alors que la valeur effectivement ajoutée par l'entrepreneur et n'ayant pas encore supporté la taxe, ne comprend en général que la masse des salaires (directs et indirects) et des bénéfices.

En somme, la différence fondamentale entre le système de la taxe à la production, assorti de la règle des payements fractionnés, et le système théorique d'une taxe sur la valeur ajoutée provenait du fait que le premier était basé sur un critère de déduction physique, alors que le second est basé sur un critère de déduction financière, ou comptable. [3])

Pour réduire cette différence fondamentale, il suffisait donc de procéder à un changement du critère de déduction, ou d'admettre, en plus de la déduction des biens intégrés physiquement, celle des amortissements, des frais généraux et des services. C'est ce qui fut fait progressivement.

Le législateur autorisa d'abord la déduction de la moitié des investissements donnant lieu à amortissements, à compter du 1er octobre 1953, puis de la totalité, à compter du 1er avril 1954. La condition relative à l'amortissement fut elle-même supprimée à compter du 1er juillet 1954, tous les investissements devenant dès lors déductibles, à la condition qu'ils soient affectés à la fabrication de

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[3]) Cf. Maurice Lauré — La taxe sur la valeur ajoutée. — Sirey, 1952.

produits soumis à la T.V.A. ou exportés, que leur acquisition entre dans le cadre des besons de l'entreprise, et qu'ils aient eux-mêmes supporté la T.V.A.

Les services furent également progressivement déductibles, la déduction générale étant définitivement autorisée à compter du 1er juillet 1955.

Enfin, les frais de fabrication et les frais de vente furent, sous les mêmes conditions d'ordre économique que les biens d'investissements, admis en déduction à compter du 1er juillet 1954.

La plupart des principes de la réforme sont contenus dans la loi du 10 avril 1954.

Parvenue à ce degré de son évolution, la taxe était devenue effectivement une taxe sur la valeur ajoutée, mais limitée aux stades de la production.

Un décret du 30 avril 1955 étendit le champ d'application de la taxe sur la valeur ajoutée au stade du commerce de gros, ainsi qu'à certaines entreprises de commerce de détail intégrées. Corrélativement était supprimée la taxe sur les transactions, impôt à cascade créé en 1939.

Depuis cette date, la situation est la suivante:

a) une taxe sur la valeur ajoutée, au taux général de 19,50 % couvrant l'ensemble des circuits jusqu'au stade du commerce de gros inclusivement;

b) une taxe sur les prestations de services, déductible de la T.V.A.;

c) une taxe locale aux taux variables entre les limites de 2,20 % et 2,75 % atteignant le stade du détail et assurant en quelque sorte le relai de la T.V.A. à ce stade.

II. *Les différences essentielles entre le système Français actuel et un système ideal de taxe sur la valeur ajoutée* [4])

Le caractère fondamental de la T.V.A., du point de vue économique, est comme nous l'avons dit, de respecter le postulat de la neutralité fiscale, ou, pour écarter cette terminologie qui prête à confusion, *de ne pas modifier les rapports respectifs des données numériques du milieu économique considéré.*

Or, ces rapports respectifs ne peuvent être maintenus constants que par une taxation uniforme de l'ensemble des biens sur toute la longueur des circuits.

C'est donc en définitive dans sa *généralité* que la T.V.A. trouve l'essence de son caractère fondamental.

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[4]) Pour simplifier l'exposé, nous désignerons par T.V.A., la taxe idéale, et par taxe française, celle actuellement en vigueur.

Et c'est dans les atteintes à ce principe de généralité que doit être recherchée l'origine des différences essentielles qui subsistent entre le système français actuel et un système parfait de T.V.A. Ces atteintes portent sur quatre points:

a) le champ d'application de la taxe quant aux circuits;
b) le champ d'application de la taxe quant aux produits;
c) le champ d'application de la taxe quant aux entreprises;
d) la dualité de taxation des biens et des services.

a) *Le champ d'application de la taxe quant aux circuits.*

Afin de conserver une rigoureuse égalité de taxation entre les circuits et entre les produits, la T.V.A. doit s'étendre sur toute la longueur du circuit, depuis l'origine jusqu'au stade du détail inclusivement. La taxe française ne couvre le circuit que jusqu'au stade du commerce de gros inclusivement, laissant le commerce de détail hors du champ d'application.

Sans doute, on pourrait objecter que les circuits sont ainsi fiscalement amputés du dernier stade d'une manière uniforme, et que cette amputation *uniforme* de tous les circuits est sans conséquence. Cet argument n'est pas satisfaisant, car il néglige un nombre important de cas particuliers, et notamment ceux des producteurs vendant directement au détail, qui constituent généralement eux-mêmes leurs propres grossistes. Dans ces divers cas, le législateur français a dû prévoir des modalités arbitraires de taxatíon, qui pour aussi bien étudiées qu'elles soient, ne peuvent refléter exactement la situation réelle, et de ce fait troublent l'orthodoxie du système.

b) *Le champ d'application de la taxe quant aux produits*

Le système de la taxe à la production laissait l'activité agricole en dehors de son champ d'application. Par ailleurs, il s'est trouvé assorti, au cours de son évolution, d'un grand nombre d'exonérations, de taux réduits et majorés, et de régimes spéciaux, qui l'ont rendu particulièrement complexe.

Beaucoup de ces exonérations et de ces situations particulières ont été conservées dans le système actuel. Elles ont pour conséquence, non seulement de compliquer l'application de la taxe, mais encore de la fausser dans son principe, pour les raisons ci-dessus exposées.

Au surplus, certaines de ces situations particulières ont été résolues de façon non satisfaisante, économiquement.

Un exemple important en est fourni par le régime des produits agricoles ayant subi une préparation industrielle (conserves).

La plupart des produits agricoles ou de la pêche destinés à l'alimentation humaine ou à la nourriture du bétail étaient exonérés de la taxe à la production quant ils étaient vendus en l'état. Par contre, ils tombaient sous le coup de la taxe à partir du moment où ils avaient subi une manipulation industrielle ou commerciale, qui ne constituait pas le prolongement normal de l'activité agricole.

Si l'on veut conserver, dans un régime de T.V.A., le principe de l'exonération de ces produits, il convient purement et simplement de faire application de la règle „exemption vaut payement".

De la sorte, si le produit est livré directement par l'agriculteur au particulier consommateur, l'exonération est définitivement acquise sur la totalité du prix. Par contre, si le produit entre dans un circuit, au cours duquel il subit des manipulations industrielles ou commerciales, le premier intermédiaire acquittera la T.V.A. sur le prix de vente, mais déduction faite de la taxe calculée sur le prix d'achat à l'agriculteur, qui est ainsi considérée comme fictivement payée.

C'est du reste la solution qui avait été retenue par la loi du 10 avril 1954 (article 22, 2ème alinéa) et le décret du 29 juin 1954, en ce qui concerne les produits qui sont à la fois vendus en l'état et sous forme de conserves, lorsque ces deux présentations entrent couramment en concurrence auprès des consommateurs. Ces dispositions s'appliquaient en fait à la plupart des conserves de poissons, de légumes et de fruits.

Mais ce régime a été supprimé par le décret no. 44—465 du 30 avril 1955, article 4, § II: le principe de la déduction d'une taxe fictive a été remplacé par l'application pure et simple d'un taux réduit (12 %) à la catégorie de conserves considérée. Cette taxation forfaitaire constitue évidemment une grave entorse au système.

Il convient de signaler au surplus que quelques catégories importantes de produits sont soustraites au régime général et assujetties à des régimes spéciaux d'impositions: ce sont principalement les viandes, les vins et les cidres, les cafés et les thés, les produits pétroliers.

c. *Le champ d'application de la taxe quant aux entreprises*

Nous avons déjà rencontré un cas dans lequel une certaine catégorie d'entreprises tombe sous le coup de dispositions particulières: il s'agit des entreprises intégrées de commerce de détail. L'article 3—2° du décret du 30 avril 1955 prévoit en effet que sont assujetties à la taxe sur la valeur ajoutée les ventes au détail faites par des personnes:

— soit qui possèdent plus de quatre établissements de vente au détail;

— soit qui vendent en gros et au détail, dès lors que leurs ventes en gros ont dépassé, au cours de l'année civile précédente, la moitié de leur chiffre d'affaires total.

Cette définition des établissements intégrés est évidemment arbitraire: une entreprise groupant quatre établissements de vente au détail échappera à la taxe, alors qu'une autre en groupant cinq y sera assujettie.

Il est intéressant de noter que sous le régime antérieur à la taxe sur la valeur ajoutée, les entreprises groupant plus de deux établissements de vente au détail étaient assujetties à un taux majoré de la taxe sur les transactions (1, 80 % au lieu de 1%). La loi du 10 avril 1954, qui tout en introduisant le principe de la taxe sur la valeur ajoutée, avait laissé subsister la taxe sur les transactions, avait porté le nombre maximum d'établissements de deux à quatre. Enfin, le décret du 30 avril 1955 précité, en intégrant à la taxe sur la valeur ajoutée la taxe sur les transactions, a conservé le principe de ces dispositions.

Mais il n'est pas douteux que le fait de porter de deux à quatre le nombre maximum d'établissements, n'ait incité ce genre d'entreprises à augmenter corrélativement le nombre de leurs succursales. On voit là un exemple particulièrement intéressant d'une influence exercée directement sur les structures économiques par la fiscalité, et qui n'aurait pas dû se retrouver dans un système de T.V.A.

Du reste, la dérogation la plus importante à la règle de l'égalité des entreprises devant l'imposition, ne réside pas là: elle se trouve dans l'exonération générale dont bénéficient les artisans, héritage également de l'ancien système. Les artisans sont en effet expressément exonérés de la taxe, les conditions de cette exonération étant liées à la définition juridique de la qualité d'artisan. Or, cette définition est telle que l'exonération dont il s'agit aboutit en fait à accorder une prime importante à un grand nombre d'entreprises individuelles, souvent marginales, sous la condition essentielle qu'elles s'abstiennent de tout progrès économique. En effet, l'artisan est celui qui, vendant les produits de son propre travail, n'utilise pas d'autre concours que celui de sa femme, de ses père et mère, de ses enfants et petits-enfants, d'un compagnon et d'un apprenti. En outre, il ne peut employer d'outillage mécanique mû par la force motrice, que dans la mesure où cet outillage ne modifie pas le caractère de son activité: cet outillage doit requérir son intervention personnelle et constante, et mettre en jeu son attention, son habileté, voire sa force musculaire.

Une telle exonération aboutit donc d'une part à troubler l'équilibre du système; d'autre part, à paralyser le développement économique de certaines de ces entreprises industrielles. Cette conséquence

paraît surprenante, dans un système conçu à son origine en vue de ne pas apporter de perturbations dans les conditions de la concurrence.

Bien entendu, il n'est pas question de mettre en doute que la protection de l'artisan est souhaitable, pour des raisons sociales, et notamment en vue de permettre une certaine promotion ouvrière. Mais il est paradoxal que cette protection soit assurée, sur le plan fiscal, *au moyen d'un impôt dont la garantie du caractère fondamental réside précisément dans sa généralité.*

Elle pourrait l'être, certes, par d'autres moyens.

d) La dualité de taxation des biens et des services.

Enfin, un système rigoureux de T.V.A. exigerait une taxation uniforme des biens et des services, ces derniers entrant bien entendu, corrélativement, dans le jeu des déductions successives.

Or, le système actuel a prévu un régime spécial pour les prestations de services. Alors que le taux général de la taxe assise sur les biens est de 19,50 %, le taux général de la taxe atteignant les prestations de services est de 8,50%.

Au surplus, si la taxe sur les prestations de services est déductible de la taxe sur valeur ajoutée, depuis le décret du 30 avril 1955, la taxe sur la valeur ajoutée n'est pas déductible de la taxe sur les prestations de services.

Conclusion: L'avenir de la T.V.A. en France.

On peut donc dire en définitive que les défauts du système français actuel sont le résultat, non pas de défauts inhérents à la nature ou à la structure de la T.V.A., mais au contraire *des entorses qui ont été apportées à ses principes dans l'application qui en a été faite.*

Au surplus, certains projets de modifications dont il a été récemment question, tendraient, s'ils étaient adoptés, à troubler encore davantage l'orthodoxie du systéme. Il en est ainsi surtout du projet aux termes duquel le Gouvernement devrait déterminer certaines catégories d'investissements qui ne donneraient pas ouverture à déduction, pour le calcul de la taxe.

Déjà, un texte, d'inspiration parlementaire, a été inséré dans la loi du 14 avril 1954 instituant la T.V.A. Il s'agit de l'article 8, paragraphe 3, Ier alinéa, aux termes duquel „des décrets pris en Conseil de Ministres après avis du Commissariat du Plan de Modernisation et d'Equipement... fixeront les catégories d'entreprises qui ne bénéficieront pas de la détaxation, et les catégories de biens qui n'ouvriront pas droit à la déduction...".

Le souci des auteurs de ce texte est évidemment de permettre une orientation des investissements, les seuls investissements déclarés utiles pour l'économie générale devant donner lieu à déduction. [5]).

Or, si cette optique était adoptée, le système serait définitivement faussé.

Insistons, là encore, sur le fait qu'il ne s'agit nullement de contester la nécessité d'une politique d'orientation de l'investissement. Nous disons seulement qu'il est anormal de choisir, comme instrument d'une telle politique, précisément un impôt conçu originellement comme ne devant pas entraîner de modifications dans les structures économiques.

Que ces structures soient à modifier, et que ces modifications puissent être apportées notamment par le moyen de la fiscalité, n'est pas mis en cause: mais il faut utiliser pour cela des instruments appropriés. Et, en tout cas, s'il apparaît que cet instrument doive être recherché dans la fiscalité indirecte, il ne fallait pas commencer par adopter le principe de la taxe sur la valeur ajoutée.

Au contraire, si l'on veut conserver le principe de la taxe sur la valeur ajoutée, les modifications que l'on doit apporter au système français actuel doivent être dirigées dans le sens d'une atténuation des atteintes au principe fondamental de généralité que ce système contient, et dont nous avons énumérées quelques-unes parmi les principales.

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[5]) Le pr. Carl Shoup, dans une analyse récente du système fiscal français, se déclare également hostile à une politique discriminatoire des investissements par le biais de la taxe sur la valeur ajoutée (cf. Taxation in France, in National Tax Journal, december 1955, vol. VIII, no. 4, page 330).

SOME ECONOMIC ASPECTS OF THE FRENCH ADDED VALUE TAX

by Charles Campet

SUMMARY

Taxation as such is an economic phenomenon: any levy of taxes which is introduced in a well-balanced economic system necessarily troubles the existing equilibrium by the only fact of being introduced.

It is, therefore, impossible to consider taxes as being neutral, unless the term „economic neutrality" of taxes is reserved to the particular case of a levy of taxes which, though inevitably modifying the numerical elements of the economy concerned, would not modify the respective relations of these elements. In this sense, one can say that taxes of the type of the added value tax are neutral.

In France the added value tax which was progressively introduced represents the logical end of the historical development of the turnover tax system.

Nevertheless, the application of the added value tax system in France is not fully satisfactory.

In fact, the economic neutrality of this tax — in the sense defined above — results from its *general* character. But, under the present French system certain exceptions to the principle of generality have been maintained with regard to (1) the cycles of production and commercialisation, (2) to products, (3) to enterprises, and (4) by the levy of different taxes for goods and services.

Is is only inasmuch as these exceptions would be progressively reduced that the French system might be improved from an economic point of view.

THE BUDGET EXPENDITURES OF OUTER MONGOLIA[1])

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I. *Introduction*

The purpose of this paper is to present a comprehensive historical survey of the budgetary expenditure accounts of Outer Mongolia, or Mongolian People's Republic (MPR) as it has been known since it became a Soviet satellite in 1924. To my knowledge nothing on this subject other than a few scattered figures has ever been published before in the West.

While Outer Mongolia is a nation of only 1 million people, its meagre population hardly measures its importance in the world arena. Bounded on the north by Soviet Siberia and on the south by China, it plays an important buffer-state-role between the two nations. This role was enhanced when recently a rail line through Mongolia was completed linking Siberia and China. The people of Mongolia are outnumbered 30 to 1 by their livestock and this provides the key to understanding the Soviet Union's economic interest in the country. For as is well-known, the Soviet Union faces serious livestock problems; these are somewhat ameliorated by the opportunity to import large numbers of livestock and quantities of livestock products from the MPR. In return, the Soviets ship the Mongolians grain products and manufactured goods.

It is worth noting that the Mongolian People's Republic is the only Soviet satellite to survive the prewar period as an "independent" nation. As such it provides an interesting case study of USSR-satellite relationships. As we shall see, the form of the Mongolian budget and to some extent the pattern of expenditures follow in the Soviet image.

II. *Budget Structure*

As in the case in most other countries, the various political entities included in the Mongolian People's Republic each maintain

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[1]) The author is associate professor of economics at the University of Washington and is associated with the Far Eastern and Slavic Institute at the University. The generous assistance of the Human Relations Area Files, Inc. in making this study possible is gratefully acknowledged. Materials were collected under the project on Outer Mongolia operating under contract with the Human Relations Area Files, Inc. (HRAF Subcontract HRAF-10 Washington-1).

a set of financial accounts or budget, which indicates on the one hand the nature of the activities in which the entity engages, and on the other, the source of revenue by which these activities are financed. For the past thirty years, detailed statistical information has been available only for the so-called unified budget of the MPR. This budget is a composite of the budgets of the central government (called republican budget), local governments (both state (called aimak) and city governments), [2]) as well as the special social insurance budget. The unified budget is akin, in structure, to the consolidated budget in the United States which comprises the federal, state, and local budgets, and to the unified budget of the USSR which comprises the budgets of the Union government itself, the various republics, the local governments, and also the social insurance budget. There is a substantial difference in the interrelationship between budgets in the various nations, however. In the United States, the federal, state, and local governments operate their budgets in substantial independence of one another. With a few exceptions, each government is free to decide the size of its expenditures, the nature of the projects it wishes to undertake, and types of taxes or loans or both to be used to support such undertakings. In the MPR, and even more so in the USSR, the emphasis is on the consolidated or unified budget. [3]). This follows from the fact that political and economic power is so much more centralized and, related to this, the fact that the number and extent of economic activities undertaken and planned for by the state is so much greater in the MPR and USSR than in the United States. The aimak and city governments in the MPR do have operating budgets, i.e. they collect taxes and spend the money so collected to carry out various legitimate functions (see below). But the budgets of these governments are in important part dictated from above and, in any case, are subject to approval, as part of the unified budget, by the central government authorities. [4]).

The division of expenditure among the budgets [5]) is based on the principle that the republican budget (that of the central government) finance those activities of national significance (e.g. defense, national administrative expenses, financing of state industry and other industry of national importance, universities, etc.) while the local budgets finance those activities which are of less crucial sig-

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[2]) In 1953, there were nineteen separate local budgets. Cf. Tsapkin, p. 72.

[3]) This explains why the available data refer in the MPR primarily to the unified budget and in the United States to the individual budgets.

[4]) This information taken from the decree "On the Budget Laws of the Mongolian People's Republic" (dated September 11, 1944), Part I, articles 2, 3, 4.

[5]) Ibid., Part II.

nificance and which are more easily handled, from an administrative point of view, by aimak and city governments (e.g. local industries, lower school system, local administrative expenses, smaller hospitals and dispensaries, local housing and construction expenditures, etc.). The social insurance budget includes expenditures for the support of rest homes, disability relief, old age pensions, etc.

The available data indicate some fluctuation in the relative importance of the local and republican budgets:

Table 1

LOCAL BUDGET EXPENDITURES AS A PERCENT OF UNIFIED BUDGET

Year	1930	1935	1938	1940	1942	1949	1950	1951
Percent	31.0*)	20.3	12.7	15.5	14.5	24.0	27.0	26.3

*) This figure represents the ratio of local budget *receipts* to unified budget. Sources: 1930 — Schleifer, p. 23; 1935, 1938, 1940 — Vargin — Zlatkin, p. 231; 1940, 1949, 1951 — Tsapkin, p. 72; 1950 — Maslennikov, p. 140.

The decline in importance of the local budgets, hence the rise of of the replublican budget, from 1930 to 1938 no doubt indicates an increase in the power of and number of activities engaged in by the central government. The period from 1938 to 1944 is one of relative stability after which the importance of the local budget once again rises. This rise is attributed by Tsapkin [6] to the growth of the network of agricultural institutions, and to the increase in education and health services. Since the dispensing of education and health services constitutes about two-thirds of all local government activity, [7] an increase in these items could certainly have had the effect indicated by Tsapkin. And the tables on budget expenditures do indicate a steady increase in the proportion of social-cultural expenditures (predominately education and health) in the unified budget in this period: from about twenty percent in 1940 to 31.5 percent (plan) in 1953.

It is interesting to note that the relationship between budgets in the MPR is similar to that in both the United States and the USSR In the Soviet Union in 1949, for example, the budget of the central

[6]) Tsapkin, p. 72.

[7]) Education and health expenditures totaled 72.1 percent in 1950 and were planned in 1953 at 66.1 percent of total local budget expenditures. Cf. Maslennikov, p. 140 and Tsapkin, p. 72.

government disbursed seventy-eight percent of all funds whereas local budgets disbursed twenty-two percent; [8]) in the United States in 1948, the percentages were seventy-four and and twenty-six respectively. [9]). This similarity in breakdown is no accident but reflects the similar division of governmental activities between central and local governments which prevails in many nations.

III. *Expenditure Categories*

Budgetary expenditures [10]) may be subdivided into the following major categories: financing the national economy, social-cultural expenditures, expenditures on administration, on defense, and on other or miscellaneous items.

Expenditures on the national economy are subdivided by destination, in the budget laws, as follows: industry; trade; livestock; agricultural and transportation; construction; public services; and others. Data have been made available only for industry and livestock however. Although there is no explicit indication as to the precise nature of these expenditures, investment in fixed and working capital is, no doubt, a major component. This is deduced as follows. Data for investment have been broken down for a couple of years into investment financed by the budget and that financed by enterprise funds. In the projected budget for 1953, for example, of a total investment of 90.0 mn. tugriks, [11] 71.7 mn. was to be financed through the budget. This amounts to almost three-fifths of total expenditures on the national economy which were planned at 123.5 mn. tugriks in 1953. Since most of the nation's investment is likely to have been directed at the national economy, it can be assumed that half or more of the expenditures on the national economy consists of investment in fixed and working capital. There is no indication in the literature as to the nature of the remaining expenditures on the national economy; Soviet practice here would appear to be a good guide, however. In addition to investment in fixed and working capital, Soviet expenditures on the national economy are classified as follows: (1) subsidies to some state enterprises designed to keep prices below costs and to offset unplanned losses, (2) expenditures on enterprises and organizations which may be included in the budget on a gross basis (e.g. the post office) and (3) expenditures for: training workers, scientific research,

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[8]) Rovinski, p. 47.

[9]) Schultz and Harriss, p. 38.

[10]) From now on we refer only to the unified budget.

[11]) Tugrik is the Mongolian currency unit. It is currently equal in value to the ruble.

geological exploration, and other projects which are not likely to be part of the normal expenses of production of individual enterprises. [12]). Since (3) is not apt to be a very large item, most of the remaining expenditures must fall in (1) and/or (2). Returning to investment for a moment, it seems probable that the funds are advanced as gifts or subsidies to state enterprises rather than on a credit basis since there is no evidence whatsoever that repayment is required. This also follows the Soviet practice. Some investment *is* financed by the state central bank (called Mongol-bank), however, as well as from the retained profits of state and other enterprises; neither category of investment appears in the budget accounts.

Expenditures on social and cultural items are predominantly (eighty to ninety percent) for education and health purposes. Expenditures on these categories presumably include: the payrolls of teachers, doctors, nurses, librarians, etc.; supplies for and upkeep of schools, libraries, clubs, nurseries, hospitals, etc.; possibly some construction (although this may be included under national economy: construction); etc. The remaining social and cultural items are: art, science, and social security and social insurance. Art and science are self-explanatory. Social security and social insurance include: relief for temporary work disability, old age and invalid pensions, medical assistance, other assistance (burial, feeding of children, etc.) [13]). According to the law, the funds collected through the social insurance markup or payroll tax are to be earmarked for those items mentioned above which are connected with the individual's work experience, are to be paid by the employer (or employing unit), and are to be supervised by the Central Council of Professional Unions. These funds constitute, in effect, the receipts side of the social insurance budget referred to earlier.

Defense and administration are the remaining two major expenditure categories. Defense probably includes, as in most other countries, the expenditure of the government department in charge of military operations. The major items in this category would be, then, the military payroll, the cost of feeding, clothing, and housing troops, and the procurement of guns, tanks, and other matériel. Probably not included here, but under national economy, would be investments in plant and equipment to produce matériel. It has been alleged [14]) that the Soviets contribute support to the Mongolian

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[12]) Cf. Holzman, 1953, p. 239.

[13]) For details, see the statute on "On Social Insurance in the MPR" dated January 22, 1942.

[14]) Cf. Dallin.

military establishment. Such support has not been acknowledged by the Mongolians nor can it be distinguished in the budgetary accounts. If this support comes in the form of below-cost prices for Soviet material purchased by the MPR Ministry of Defense, this would be reflected in the budget simply as a smaller figure for defense expenditures than if the full price had had to be paid; or perhaps the defense figure would have remained roughly the same but a larger quantity would have been purchased.[15]). Administrative expenditures include, as is usual, the costs of supporting the government in the performance if its traditional functions, i.e. paying the expenses of the normal government departments. This includes, in the MPR, the purely administrative expenses of the Ministry of Defense.

All remaining expenditures are included in the "other" category and, with a few exceptions dating back to the 1920's, are not quantified in the available published literature. Among these items are: the loan service on the national debt, expenses connected with the operations of the State Treasury (loans, purchase of precious metals), the reserve fund of the Council of Ministers and of aimak and city agencies (the purposes of these funds are obscure), and others. The sheer size of the other category, especially in recent years, leads us to believe that is includes additional and possibly important items concerning which we have no information.

Expenditure Trends

Budget expenditure data for major categories and for selected years are presented in Table 2.[16]).

Perhaps the most striking feature of the figures presented in Table 2 is the almost seventy-fold increase in total budgetary expenditures which took place from 1924 to 1953. Annual rates of change are shown in Chart I. Although we have virtually no information concerning price changes in the MPR, it seems difficult to believe that any factor other than inflation could have been primarily responsible for an increase of such great magnitude. Three other factors which may have played a minor role in the picture are: increases in real national income, increases in government activity as a proportion of real national income, and the shift from taxation and expenditures in kind (not reported in the budget) to monetary tax-

[15]) Other accounting arrangements are possible such as if the Ministry of Foreign Trade had purchased the matérial and then resold it to the Ministry of Defense. But there is not much point in following through the impact of all of these arrangements on the budget in view of the fact that the budget accounts are not presented in sufficient detail to make analysis possible.

[16]) Further details can be had from the author upon request.

Table 2

BUDGETARY EXPENDITURES OF THE MPR AND USSR FOR SELECTED YEARS

	Mongolian People's Republic (millions of tugriks)							USSR (billions of rubles)
	1924 (or 1923 *)	1930	1934	1938	1940	1945	1953 Plan	1950
ɔnal Economy of total	1.9 (19.4)	5.9 (21.9)	9.9 (26.4)	11.6 (13.0)	26.7 (21.9)	33.1 (11.5)	123.5 (28.6)	157.3 (38.1)
l-Cultural of total	0.224 (3.3)	6.8 (25.3)	5.0 (13.3)	14.4 (16.2)	24.1 (19.7)	73.9 (25.7)	136.1 (31.5)	116.8 (28.3)
ich:								
ucation of total	.216 (3.2)	4.8 (17.8)	2.0 (5.3)	5.3 (6.0)	10.0 (8.2)	—	72.3 (16.7)	59.5 (14.4)
alth of total	.034 (0.1)	2.0 (7.4)	2.4 (6.4)	6.5 (7.3)	10.0 (8.2)	—	36.5 (8.4)	22.0 (5.3)
nistration of total	.3* (7.8)	4.7 (17.5)	3.7 (9.9)	4.4 (4.9)	12.7 (10.4)	141.8 (49.3)	33.6 (7.8)	13.8 (3.3)
ıse of total	1.8 (41.8)	5.0 (18.6)	13.0 (34.7)	46.8 (52.6)	56.9 (46.6)		50.0 (11.6)	82.9 (20.1)
r of total	—	4.5 (16.7)	5.9 (15.7)	11.7 (13.3)	17.0 (13.9)	38.9 (13.5)	89.0 (20.5)	41.9 (10.2)
Total:	6.7	26.9	37.5	88.9	122.1	287.7	432.2	413.3

Sources:

1923: Zlatkin, pp. 174—175.
1924: National economy - Tugarinov, p. 175; social-cultural - Tsapkin, p. 70; education and health - Zlatkin, p. 175.
1930: Defense - Schleifer, p. 24; all others - Vargin-Zlatkin, p. 226.
1934: Administration - Ryzhik, p. 187; all others - Vargin-Zlatkin, pp. 227—230.
1938, 1940: Administration - Zlatkin, p. 242; all others - Vargin-Zlatkin, pp. 227—230.
1945: Vargin-Zlatkin, p. 235.
1953: Tsapkin, p. 70. USSR, 1950: Holzman, 1953, p. 244.

Note: Different writers often gave different figures for the same categories; in other instances indirect methods of estimation were used. The figures presented in Table 2 were the best in the writer's opinion. A full statement of sources and methods of estimation can be obtained from the writer upon request.

ation and expenditures. Increases in real national income could be responsible for, at most, a doubling of budget expenditures. Most Soviet commentators are agreed that from $^2/_3$ to $^3/_4$ of Mongolian national income is still generated by the livestock industry; and the increase in livestock herds since the 1920's has been small indeed. [17]). The relative importance of government activity in the national economy has undoubtedly increased substantially since Mongolia became a Soviet satellite. This factor was probably of greatest importance in the 1920's. By 1930, the ratio of budget expenditures to national income had reached 31.5 percent. [18]). A ratio of 31.5 percent implies already a fairly substantial degree of state economic control for a nomadic economy and it is unlikely that this ratio has been increased very much since 1930. Shifts from budgeting in kind to monetary budgeting occurred on a substantial scale first in the late 'twenties and then again in 1949 at which time the traditional obligation of the nomads to supply the government with transportation services was finally revoked. In recent years, the rate of budgetary increase has slowed down considerably. This must be attributed to the fact that the Mongolians, like the Soviets, have been successful in controlling inflation in the postwar period. [20]).

Several clearly discernible cycles in the relative importance of the major expenditure categories occur in the period 1923—1953. These are perhaps most easily visualized in the attached Chart II. [21]). The period from 1923 to 1930 is marked by some sharp changes: a drastic and continuous decline in defense expenditures from forty-two to nineteen percent, a sharp and continuous rise in social-cultural expenditures, a sharp increase followed by a sharp decrease in administrative expenditures, and an increase-decrease-increase in expenditures on the national economy. As we noted earlier, the role of the government in the economy probably increased very rapidly in the twenties as the economy and the nation became better organized. The rapid decline in the importance of defense expenditures probably reflects not an actual deemphasis of defense, although this may also have been true to a minor extent, [22]) but rather the

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[17]) Murphy, part II.

[18]) Budget expenditures for 1930 from Table 2; national income from *SSE.* p. 535.

[19]) Cf. Holzman, 1957, *passim.* This source contains a more detailed discussion of the reasons for the increase in the Mongolian Budget.

[20]) *Ibid.*

[21]) This Chart and Chart I are based on more extensive data than are contained in Table 2. The writer's complete accounts for the MPR can be had upon request.

[22]) Absolute expenditures on defense do increase three-fold from 1923 to 1930 without allowing for the effect of inflation.

CHART I

GOVERNMENT EXPENDITURES, ANNUAL PERCENTAGE CHANGE

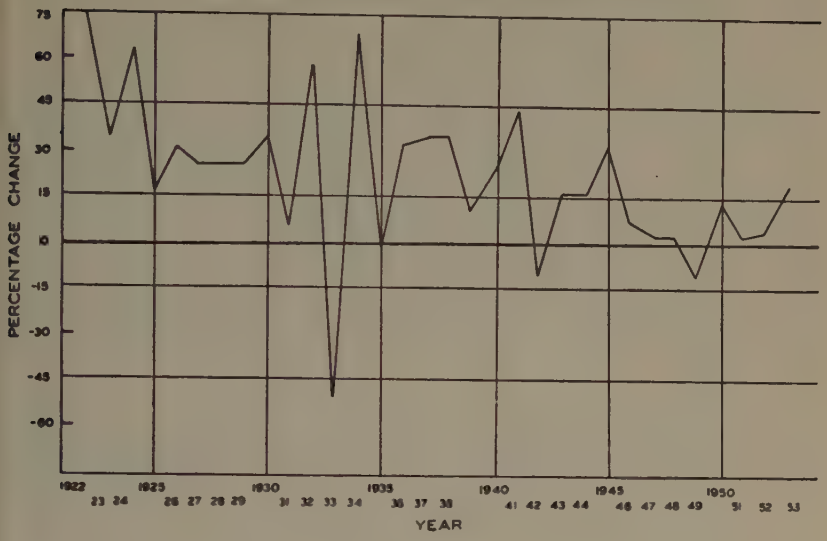
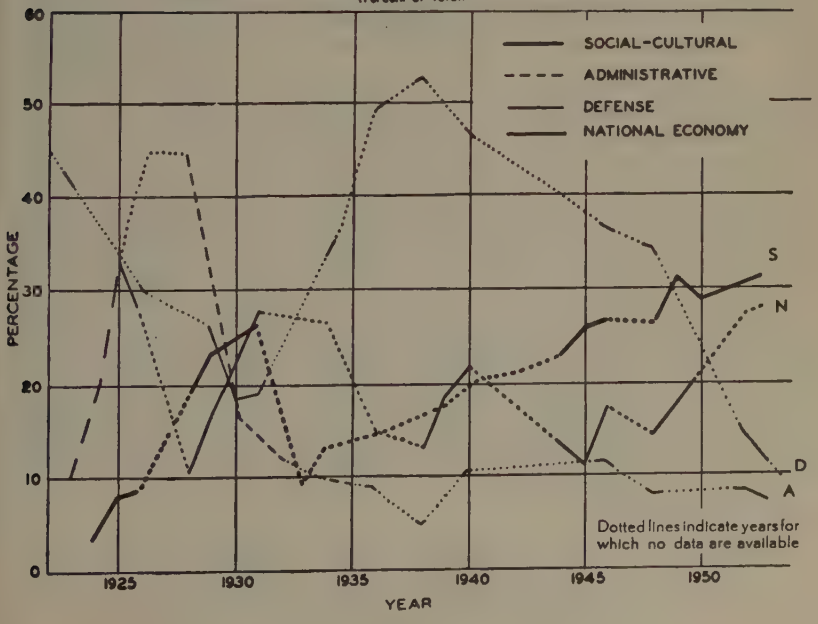


CHART II

RELATIVE IMPORTANCE OF GOVERNMENT EXPENDITURE CATEGORIES

(Percent of Total)



effect of government moving in and taking over responsibility for other phases of the economy heretofore in private hands. This would appear to be particularly true of social and cultural expenditures on education and health which increased very substantially indeed. The relative increase in administrative expenditures from 1923 to 1928 reflects the operation of two factors. As the government stepped in to increased control over the economy, costs of administration naturally increased. In addition, it has been asserted that in the early 'twenties, many economic expenditures were classified under administration. This might be a partial explanation of the drop in expenditures on the national economy from 1925 to 1928; and reclassification of many administrative expenditures as economic after 1928 may constitute a partial explanation of the simultaneous sharp decline in the former and rise in the latter in the immediate subsequent years.

The 'thirties are marked by the following trends: defense climbs some thirty-five percentage points, administration continues to decline (albeit rising slightly from 1938 to 1940), social-cultural expenditures drop abruptly between 1931 and 1933 and then begin a climb which is maintained almost continuously up to the present, expenditures on the national economic again change direction three times first rising, then falling, and finally rising again. The overwhelming rise in defense expenditures without doubt represents the Mongolian reaction to Japanese military build-up and expansion into Manchuria, Inner Mongolia, and finally the actual skirmishing between Japanese, on the one hand, and Soviet and Mongolian troops on the other, on the Mongolian border in 1939.[23]). After the 1939 skirmish in which the Soviet-Mongolian troops won a decisive victory, the Japanese turned their interests to the south and east with the result that the MPR was able to allow some reduction in its defense expenditure. Expenditures on the national economy appear to be inversely correlated with defense expenditures in the 'thirties, declining from 1931 to 1938 and rising from 1938 to 1940. This is to be expected. A government which undertakes heavy defense expenditures usually has to cut back other activities; typically investment in the national economy suffers most because of the close substitutability of resources between the two sectors (tractors-tanks, workers-soldiers, etc.). No explanation is offered for the sharp drop in social-cultural expenditures between 1931 and 1933. The steady rise, thereafter, is typical of the pattern of countries in the Soviet orbit.

Trends as indicated on Chart 2 may be very misleading for the

[23]) Cf. Vargin — Zlatkin, p. 231.

1940's because of the absence of data for consecutive years. Thus, while defense shows a decline from 1940 to 1946, an increase reflecting the MPR's expectations concerning World War II may have occurred somewhere between these years. Similarly with other expenditure categories. Generally speaking this period appears to have been characterized by a decline in defense and national economy and a rise in social-cultural expenditures. From 1946 to 1953, expenditures on defense continue to decline and social-cultural expenditures continue to rise. Expenditures on the national economy increase again quite steadily after 1945 with the exception of the year 1948. This reflects, no doubt, both the substitution of investment for defense expenditures as well as the impact on the budget of implementing the First Five year Plan (1948—1952). Administrative expenditures behave quite characteristically after 1940, declining at a very slow rate.

In the last column of Table 2, Soviet budget expenditures for 1950 are presented. Comparison between the two nations is difficult because the patterns of expenditures over time of each have undergone such change. Looking at the USSR-1950 expenditures and Mongolian expenditures for 1953, we note the Soviet Union with 10 percent larger shares allocated to defense and to national economy, but somewhat less allocated to "other" and to administration; social and cultural expenditures rank about equally in the budgets of the two nations. While these differences are not insubstantial, they are small compared with the differences between the present Mongolian budget and those which existed prior to 1920. The latter are presented in Table 3.

Administrative expenditures loom quite large, constituting the first two and part of the third items. Defense is also quite a substantial item. The reform fund and princes' pensions no longer appear in the budget, of course. The fund has a potpourri of items, about two-fifths of which was devoted to various governmental reforms and to the support of a Russian Advisory Commission on Governmental reform; much of the remainder was spent on the support of government enterprises such as the post office, coal shafts, and so forth. An insignificant fraction of the fund was spent on veterinary services and a similar fraction on education. Present Soviet writers stress the fact that these items were small and that the budget contained no expenditures at all for health.

Table 3

CENTRAL GOVERNMENT BUDGETARY EXPENDITURES OF MONGOLIA, 1913—1918

(as percent of total)

	1913/14	1914/15	1915/16	1916/17	1917/18
Administration of central institutions	22.2	19.2	18.8	18.1	17.5
Administration of provincial institutions	2.5	2.4	2.2	2.9	3.4
Clerical and economy expenditures	23.7	20.4	18.5	20.1	11.4
Defense	27.8	24.0	21.9	21.3	25.3
Princes' pensions	10.0	8.5	7.8	8.4	8.3
Reform funds	13.8	25.5	30.9	29.2	34.1

Source: Maiskii, p. 283; also Zlatkin, p. 97. The writer has many qualifications concerning the absolute data from which these percentages were calculated. Many of the figures seemed „normative" or planned since they were rounded and did not change from year to year. It should also be noted that the central budget was only a small part of total expenditures, about two-sevenths, local budgets making up the bulk.

For 1916, Zlatkin, p. 99 gives the following breakdown for local budgets (major items only):

transportation services - 36 %
liquidating government debt - 20.8 %
religious needs - 14.3 %
defense - 9 %.

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This volume contains the following articles:

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„Torgovlya" by N. T. Vargin

„Sel'skoe khozyaistvo" by F. S. Tsaplin

„Transport i svyaz" by F. S. Tsaplin

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LE BUDGET DE DEPENSES DE LA MONGOLIE EXTERIEURE

par le Professeur Franklin D. Holzman

RÉSUMÉ

La Mongolie Extérieure, ou bien la République Populaire de Mongolie, sous lequel nom elle est connue depuis 1924, s'est trouvée dans la zone d'influence soviétique depuis cette date.

Sous beaucoup de rapports son budget est composé à l'image soviétique. Ainsi, alors que les villes, les états (appelés aimaks) et le gouvernement central ont leur propre budget à eux, les données disponibles se rapportent presque exclusivement au budget unifié ou consolidé. Egalement les Mongoliens suivent de près l'exemple de Soviets dans leur classification des dépenses budgétaires.

Les principales catégories sont:

(1) financement de l'économie nationale — il consiste surtout d'investissements et de dépenses pour subventions et primes;
(2) dépenses dans le secteur social-culturel — surtout dans les domaines de la santé et de l'éducation;
(3) défense, et
(4) administration.

On peut distinguer les principaux mouvements relatifs dans les dépenses. Les dépenses dans le secteur social-culturel ont augmenté assez graduellement depuis 1924 et cela d'environ 3 à 17 % du total des dépenses. Les dépenses pour l'économie nationale et pour la défense ont montré un mouvement dans une direction opposée l'une par rapport à l'autre. C'est sans doute parce que les fonds employés dans les deux secteurs peuvent facilement se substituer. Les dépenses pour la défense ont diminué de 42 pour cent en 1924 jusqu'à 19 pour cent en 1930. En 1930 il y avait une réconstruction militaire dans le but de préparer la nation à résister à l'attaque japonaise qui eut lieu en 1939. En 1938 les dépenses pour la défense avaient dépassé 52 pour cent du budget. Après la deuxième guerre mondiale elles diminuaient de nouveau et se montaient en 1953 à 12 pour cent seulement des dépenses totales. Depuis la guerre les dépenses pour l'économie nationale ont augmenté de 12 à 29 pour cent du budget. De 1924 à 1953 les dépenses budgétaires totales ont augmenté soixante-dix fois. Cet accroissement doit être attribué tout d'abord à une inflation, bienqu'il y ait aussi d'autres causes telles que l'augmentation de l'intervention du gouvernement dans la vie économique et le fait qu'on est passé d'impôts en nature à des impôts monétaires.

CENTRAL SUPERVISION OF LOCAL FINANCE — A COMPARATIVE STUDY

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Local governments are rarely permitted to function without substantial control over their finances from above. This generalization is essentially the same whether the government structure is unitary and the central government supervises local governments directly, or whether, in a federal system, supervision is lodged with the state or provincial governments. The term "central supervision" in this article refers to both types of control over local finances.

Three countries have been selected for this comparative study, partly because of the familiarity of the author with the facts in these countries; partly because they all belong to the Western democracies and their institutions are sufficiently similar to make comparisons meaningful; and partly because within this group are found examples of central supervision both within federal and unitary systems. These three countries are the United States, Canada, and Great Britain.

Administrative methods employed by central governments in supervising local financial affairs can be classified in accordance with their objectives under two general headings: (1) those which tend to be restrictive in nature and whose aim is to establish minimum standards of performance, or to control or prohibit specific local practices; (2) supervisory techniques designed to encourage localities to exceed the minimum, to develop financial systems in response to their specific needs, and to encourage local experimentation and initiative. Of course, it is apparent that all administrative devices employed in these three countries do not fit neatly into these two classifications. Nevertheless, the main contrast is between curtailment and stimulation, between control and persuasion.

The major emphasis of the British system is upon positive stimulation, encouragement, and education of local authorities and officials although the enforcement of minimum standards is by no means neglected. In the United States, on the other hand, central supervision is less well developed. State governments have with a few exceptions largely restricted their role to controlling somewhat negatively local fiscal affairs, insuring minimum standards of performance often at exceedingly low levels, preventing specific abuses, and dealing with emergency situations. The conservation of fiscal

resources in the localities and the maintenance of low tax levels are goals of supreme importance and have played an important part in inducing legislatures in many states to sanction supervisory programs. The objectives of Canadian provincial supervision are more similar to those of the American states than to those of the British central departments, but substantially more emphasis has been placed upon the utilization of positive devices in Canada than in the United States.

To compare the degree to which central governments exercise administrative supervision over local authorities is a difficult task. Within the United States and Canada, great variations exist between the respective states and provinces. The situation is fluid and constantly changing, and the actual extent of supervision is seldom reflected accurately in the statutes and written reports. However, with due recognition of these limitations, it is apparent that in none of these countries is local government so free of central administrative supervision as it is in the United States (New York, New Jersey, and several other states are, of course, exceptions). Canadian local governments are somewhat more closely supervised than those in the United States, while in Britain the greatest degree of supervision and control exists.

ORGANIZATION

The type of administrative organization utilized by central governments in supervising and controlling the financial affairs of local authorities varies widely. In some instances responsibility falls to one of the major non-fiscal departments dealing primarily with such matters as health, education, welfare, or road construction; or it may rest with an agency concerned primarily with finance. In others special administrative agencies have been created for the exclusive purpose of dealing with local governments generally or with local finance exclusively.

In Britain most of the important responsibilities concerning the financial aspects of local government are discharged by five principal departments. These include: Ministry of Education — primary, secondary, and other types of education; Ministry of Health — those local health services retained locally following the passage of the National Health Service Act in 1946; Ministry of Housing and Local Government — water and sewage facilities, housing, planning, local government and finance; Home Office — police, fire, and civil defense; Ministry of Transport — highway construction and maintenance. [1]) The Ministry of Education and

[1]) Standard works dealing with central supervision of local authorities in

the Ministry of Housing and Local Government employ large staffs to work with local governments; in the former, the education inspectorate alone numbers more than five hundred and in the latter, the audit service is equally large.

The organizational pattern found in most American states is, like that of Britain, characterized by a lack of centralization — only in a few instances are substantially all supervisory powers exercised by a single state agency. Two general types of supervisory agencies exist: (1) the principal agency, usually primarily concerned with accounting duties, to which have been added auditing, budgeting, debt, and other functions; (2) a secondary type established to supervise or to act as a reviewing body for a specific operation. The main supervisory agencies include tax commissions, state auditors, comptrollers, state departments of finance and other agencies; secondary agencies comprise not only appellate bodies, but also units dealing with a single function such as accounting, reporting, budget and debt administration. Since information concerning supervisory organization and current administrative procedures in each of the forty-eight states is not readily available, consideration of American practice concerning all local governments (counties, cities, townships, etc.) is limited to seven states which were investigated by the author. In addition, a recently published monograph dealing with supervision of municipal finance throughout the country is the source of useful data pertaining to the supercision of city fiscal affairs.[2])

A variety of organizational patterns occur in the states selected for study. And in none is central supervision of local fiscal affairs completely entrusted to a single agency or department. Thus, in New Jersey major responsibility for this function rests with a division of local government in the department of the treasury with limited supervision by other departments in welfare, education and other fields. The division is divided into two separate units: (1) the office of the director of local government; and (2) the

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Britain include: Herman Finer, *English Local Government* (4th ed.; London: Methuen and Co., Ltd., 1950); D. N. Chester, *Central and Local Government* (London: Macmillan and Company, Ltd., 1951); E. L. Hasluck, *Local Government in England* (2nd ed.,; London: Cambridge, University Press, 1936).

[2]) The following states were selected as being representative of the various types of supervisory systems and are here utilized for purposes of study and analysis: Georgia, Louisiana, Michigan, New Jersey, New York, North Carolina, and Wyoming. The most recent survey of American state practices is T. E. Mc Millan, *State Supervision of Municipal Finance* (Austin: The University of Texas, 1953). Earlier studies include: *State-Local Relations* (Chicago: The Council of State Governments, 1946); Wylie Kilpatrick, *State Supervision of Local Finance* (Chicago: Public Administration Service, 1941).

local government board. The latter functions primarily as an advisory and appellate organ while the director is responsible for most of the actual administrative supervision. [3])

Financial supervision is somewhat less unified in New York state where, in addition to the Division of Municipal Affairs in the Department of Audit and Control, control powers of considerable significance are exercised by the departments of health, education, social welfare, and housing. [4]) In North Carolina three administrative agencies carry the bulk of the burden — the State Board of Assessment, the Local Government Commission, and to a somewhat lesser extent the Institute of Government which is affiliated with the state university. Organizational disingtegration is found in an extreme form in Georgia where in addition to the audit of school accounts by the state auditor, limited supervision is extended by the departments of education, public health, and revenue. New Jersey and New York have developed fiscal supervision over localities to a greater extent than the other states; Wyoming, North Carolina, Louisiana, and Michigan possess much more restricted programs and Georgia has the most limited range of powers.

Canadian supervisory organization differs from that of the American states in that the tendency among Canadian provinces has been to allocate in each instance supervisory powers to a relatively small number of agencies. [5]) In all but two of the ten provinces a department of municipal affairs or its equivalent has been established and in five there is in addition a municipal board or commission. The division of functions between the department and its companion agency varies considerably, although in general it may be said that the former are administrative bodies and the latter quasi-judicial agencies with powers of debt and financial control. Thus in British Columbia the Department of Municipal Affairs is the principal supervisory agency and is empowered to exercise a wide range of supervisory and control powers. [6]) Ontario, on the other hand, employes the dual set-up, with a department of municipal affairs and a municipal board. The department licenses municipal auditors, requires local treasurers to submit annual returns, and prescribes the form of annual estimates of revenue and expenditures; the Board must approve all money by-laws and controls

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[3]) *New Jersey Public Laws, 1947,* c. 151, secs. 27—32.

[4]) *Laws of New York, 1926,* c. 614, sec. 81.

[5]) H. L. Brittain, *Local Government in Canada* (Toronto: The Ryerson Press, 1951), pp. 220—242.

[6]) *Report of the Department of Municipal Affairs for the Year Ended December 31st, 1952* (Province of British Columbia, 1954), pp. 5—22.

certain operations of local sinking funds and short-term borrowing. Supervision of local affairs is at a minimum in the province of Prince Edward Island where most municipal functions are carried out by the province. Control of finance and other aspects of local school administration is almost entirely outside the jurisdiction of the departments of municipal affairs and is vested in provincial departments of education. In this respect Canadian practice is similar to that followed in most American states where supervision of education finance is exercised by the education departments.

ADMINISTRATIVE TECHNIQUES EMPLOYED

To achieve effective supervision, guidance and control, central departments have utilized a variety of administrative devices or techniques. Some have been adopted at least to some extent in all of the countries considered here, while others have been utilized only in one or two instances. The precise way in which the individual device is employed varies, quite naturally, from country to country, and is dependent to a considerable degree upon the political climate, administrative traditions, legal or constitutional arrangements and, as has been observed in previous paragraphs, the objectives or purposes sought. Those techniques which tend to be restrictive in nature and whose aim is to establish minimum standards or to control or prohibit specific local practices will be considered first and then attention will be devoted to the use in each of the countries of those designed primarily to persuade, stimulate and educate local authorities — those administrative methods which impart to a supervisory system a dynamic and positive character.

The prescription of local accounts and record systems by central departments is an administrative device widely used in the United States and is employed to some extent in Canada. The range of state supervision varies greatly. At one extreme, the state prepares the record systems for local governments and controls in detail accounting operations; at the other, acceptance of supervision is optional and the program is restricted to advice and suggestions. Accounting principles utilized by state supervisory agencies do not always conform to modern standards; for example, many do not specify the use of accrual accounting. In recent years, emphasis has begun to shift away from requiring rigid local adherence to detailed state requirements and is moving in the direction of enforcing local observance of accounting principles with considerable leeway being permitted concerning records maintained. Of the

states surveyed North Carolina, Georgia and Michigan make little or no provision for the supervision and control of local accounts and record systems. In New Jersey not only does the Division of Local Government prescribe a uniform system of accounts for municipalities and a uniform method of reporting, but the State Board of Education enforces a uniform accounting system for every school district.[7]) New York also utilizes this device, the Comptroller being authorized to prescribe uniform systems of accounts for counties, cities, towns, and villages.

Canadian experience with this device is somewhat less extensive than that of the American states, for only three provinces make any attempt to control accounting and record keeping. In Britain, certain statutory provisions directly influence the form of local accounts; and under the Local Government Act, 1933, the Minister of Housing and Local Government can make regulations pertaining to accounts subject to district audit, setting forth the financial transactions to be recorded and the form of those accounts.

Closely related to the prescription of local accounts is the attempt by the central departments to supervise the preparation of local financial reports. Somewhat greater use appears to have been made of this administrative technique in Britain than in the United States and Canada. Supervising departments in Britain are frequently given the power to require local authorities to submit periodical or special statistical returns. For example, the Minister of Education under the Act of 1944 is authorized to require local education authorities to submit reports, returns and information.[8]) Data supplied by local authorities is usually comprehensive and may contain an analysis of income and expenditure and a breakdown of the costs of particular services. Of the Canadian provinces only four seek to control local financial reporting and some of these incompletely. Among the seven American states studied only Georgia is without any supervisory powers over local financial reporting. According to a survey published in 1953 supervision of municipalities was at that time mandatory in twenty-one states and advisory in one; of these, nineteen were required to use state-prescribed forms and in thirteen states the supervisory agency published reports on the data submitted. Sixteen states specified that the municipalities themselves publish financial reports — a requirement not generally found in Britain — but only seven states indicated that municipal reports are used at all by the state

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[7]) *New Jersey Public Laws, 1947*, c. 151, sec. 27.
[8]) *Great Britain Statutes, 1944*, 7 and 8 Geo. VI, chap. 31, sec. 92, p. 64.

government.[9]) Greater use of local reports by the central departments appears to be made in Britain; data are often published in summarized form and may be used to answer a parliamentary question or presented as evidence before a royal reached commission.

Central audit of local accounts has undoubtedly reached its fullest development in Great Britain. However, it is employed to a major extent by the American states. Audit of British local accounts is conducted by district auditors appointed by the Minister of Housing and Local Government and covers all of the accounts of county, metropolitan borough, urban and rural district councils and some accounts of county and non-county boroughs. Under existing law boroughs can voluntarily seek district audit for their other accounts and, by 1950, thirteen percent of the county boroughs and forty percent of the non-county boroughs had brought all of their accounts under central audit. In the performance of their duties, district auditors must (1) disallow every item of account which is contrary to law; (2) surcharge amount of disallowed expenditures upon the persons responsible; (3) surcharge any sum which is not brought into account upon persons by whom such sum ought to have been brought into account; (4) examine most grant claims since central departments normally rely on them for verification prior to making final payment.[10]) The district audit seeks primarily to prevent illegality of expenditure; it does not control expenditure which is within the discretion of the local authority. The strong position of the auditor, as contrasted with his counterpart in other countries, stems from his right of surcharge given directly to him by Parliament and its free exercise without the consent of the minister. Individual councillors who are surcharged suffer a two-fold penalty; not only do they forfeit the monetary sum involved, but they may be disqualified from holding office.

Canadian practice contrasts sharply with that of Britain and the United States, for only in one province is an attempt made by a central agency to actually conduct audits of local accounts. Departments of municipal affairs in three other provinces supervise to some extent local auditing arrangements; in the remaining provinces no control is exercised.

A majority of American states make some provision for either the auditing or supervision of audits of the municipalities within their jurisdiction; frequently compliance with state requirements is

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[9]) McMillan, *op. cit.*, pp. 43—47.

[10]) The responsibilities of the district auditor are defined in *Great Britain Statutes, 1933,* 23 and 24, Geo. V, chap. 51, sec. 223—35, pp. 138—142. See also Alan Wilson, "The District Audit Service," *Public Administration,* Autumn, 1950, pp. 189—98.

mandatory. A characteristic feature of the American system is the initiative allowed the municipalities by the states in choosing between the use of state employees and private auditors. American auditing arrangements differ from the British in one important respect — in a large number of instances auditing of accounts is not done on an annual basis. The limited auditing staff available to the central agency has been undoubtedly a most important contributing factor. In Britain the cost of the audit is ultimately borne by the local authorities; similarly, in America the predominant practice among states is to place the financial burden upon the municipalities. The scope of audit examinations varies; most frequently it includes legality, surety bonds, government organization and financial procedure.

Local budgets and expenditures are not extensively controlled or supervised by central governments in any of the countries under consideration, although this device is employed to the greatest extent by the American states. State governments have adopted two different approaches: (1) some supervise but permit the primary responsibility to remain with the local government, thus helping to build up local responsibility for expenditure control; (2) others, under specified conditions, attempt to substitute state for local control. Thus for municipalities, twenty-six states were reported in 1953 as having a formal law governing the preparation of budgets, but in a number of instances they applied only to certain classes of cities. Twenty-one states prepared forms to be used by municipalities in drawing up their budgets, but in only thirteen was their use compulsory. A current review or pre-audit of municipal budgets by a state agency, properly conducted, is found only in a few states; capital budgeting as a specialized area of supervision is not widely practiced. [11])

The second method of supervising local budgets and expenditures — the substitution of state for local control — takes several forms. A state may seek to control the purposes and amounts of local expenditure and provide that local taxpayers can petition for a review and possible reduction in local budgetary items and tax levies. The most common technique of tax control is the imposition of constitutional or statutory tax limits, expressed as percentages of assessed valuations, that restrict tax rates automatically.

Supervision is exercised not only by state financial agencies, but by line or functional departments. Thus in New York the budgets of state-aided public housing projects are submitted to the state Division of Housing and no major expenditure may be in-

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[11]) McMillan, *op. cit.*, pp. 50—62.

curred by the local project except as provided for in the budget or with the specific approval of the central agency.

In Britain the departments in Whitehall are not given power to control the level of local rates, nor can they prescribe in detail how money shall be spent by a local council. This does not mean, however, that central influence is non-existent, for indirect pressures can be exercised on the budgetary process by means of other control mechanisms, i.e., the issuance of regulations and the influence of the inspectors. Although provision for central control of local budgets and expenditures is much less in Canada than in the United States, it is significant that an entirely different administrative technique is used. The statutes in three provinces provide that money by-laws enacted by councils of certain classes of municipalities do not have legal effect until approved by the provincial department of municipal affairs. Where this arrangement exists, central authorities are given an opportunity to control local affairs in detail.

Supervision of local debt administration is employed by the central departments in each of the three countries surveyed; however, its greatest development has been in Britain. To the Ministry of Housing and Local Government has been entrusted the power to sanction almost all loans raised by British local authorities. Criteria employed by the central department in approving local loans include the purpose of the proposed capital expenditure, the effectiveness and economy of project planning, whether the financial position of the local authority is sufficiently sound to warrant the raising of the loan, and whether or not other public works needed by the authority merit priority over the proposed scheme. The maximum duration of the loan is fixed by the department, the other terms being left to the discretion of the local authority. The need for central approval enables the Ministry to seek conformance to the ideas of the department concerning local developments and projects, but if the department insists upon expenditures not desired locally, the authority may decline to spend money for any purpose.

In America almost half of the states are concerned with municipal debt management either on a compulsory or voluntary basis. In a large number of these local bond issues must receive state approval prior to their being issued, such a review being mainly concerned with their legality, necessity and wisdom, and past debt history. State governments frequently rely upon constitutional or statutory debt limits to restrain the borrowing propensities of localities, a practice unknown in Britain. A number of states supervise the retirement of local bonds and at least two have established a state

agency to handle the sale and distribution of municipal securities.

North Carolina is unique among the states in that it has set up a special agency to deal with local debt problems. The Local Government Commission not only approves, modifies or disapproves the issuance of bonds and other forms of loans for all local governments, but it acts as an agent to market all local securities. This centralized disposal of securities has not only resulted in substantial savings to local governments, but it removes any possibility of collusion between local public officials and local fiscal agents. [12])

A majority of the provincial governments in Canada supervise at least to some extent municipal debt operations. In some instances loan by-laws adopted by local councils require central approval while in others the expenditures of the proceeds of loans is carried out under supervision. When local governments default on their debt service, in at least four provinces their financial affairs become subject to more stringent supervision by provincial authorities; somewhat similar action is taken in a number of the American states when cities and counties get into serious financial difficulties.

Another administrative device used by central governments is that of supervision of local property assessment. This is not done in Britain, for the Local Government Act, 1948 provided that the valuation of property should no longer be a responsibility of local governments but pass to the central authority. [13]) An effort has been made in at least five of the Canadian provinces to supervise phases of the local assessment process and in one or two rather extensive systems of control exist.

Nor is supervision of local assessment well developed in many of the American states. Supervisory powers vary greatly from state to state and in almost all states some control is provided in the statutes. But in actual practice, these powers are often neglected or only partially utilized. In North Carolina a State Board of Assessment has been given the following powers: advise local officials concerning assessment methods, hear and adjudicate appeals from local taxpayers, require annual reports from counties and municipalities on prescribed forms and covering assessed valuations, tax rates, levies, collections and expenditures, assess and certify to local units the value of property owned by public utilities and the valuation of bank shares. [14]) However, only those powers pertaining to public utility valuation are currently being exercised.

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[12]) *North Carolina General Statutes*, c. 159, sec. 13.

[13]) *Great Britain Statutes, 1948*, 11 and 12 Geo. VI, chap. 26, secs., 33—43, pp. 20—29.

[14]) *North Carolina General Statutes*, c. 105, secs. 273—277

Powers frequently vested in state agencies, other than those set forth in the North Carolina statutes include interpreting tax laws, investigating complaints, issuing rules and regulations, visiting local offices, assessing properties omitted by local officers, directing or making reassessments, and ordering local boards of equalization to convene for the purpose of equalizing local assessments.

The appointment and dismissal of local finance officers may be subject to central supervision. In Canada departments of municipal affairs in several of the provinces are permitted to prescribe the qualifications of local personnel, such as municipal auditors, assessors, and treasurers. Central authorities in Britain are not permitted to control local affairs in this way and in the United States relatively few attempts have been made by state governments to supervise the selection of local government personnel responsible for finance functions.

The second group of administrative techniques utilized by central governments — those designed primarily to persuade, stimulate and educate local authorities and which impart a dynamic and positive character to the supervisory systems — are employed to a major extent only in Britain. There are, however, indications that the more progressive American states and Canadian provinces are gradually evolving supervisory systems which are to a greater degree persuasive and positive in their impact.

One of the most subtle methods of guidance and supervision which a central department can employ and which, when successfully used, is one of the most effective, is the influencing of local public opinion in favour of a particular policy. For example, central policy may call for the acceleration or slowing down of expenditure or the improvement of administrative or financial practices. This technique necessitates a thorough knowledge of the subject by the department and requires skill both in presentation and in timing. Results may be slow in materializing and they are always difficult to measure. Administrators in each of the countries considered rely upon this technique to some extent, but its most successful utililization has undoubtedly taken place in Britain.

Closely allied with this technique is the collection and dissemination of statistical data and other information by the central agency for the purpose of educating and stimulating the local authority to meet minimum standards and to increase its administrative competence. British central departments make extensive use of this method; in Canada much less is done and in the United States a relatively small volume of material is channeled to the local authorities. New Jersey appears to be something of an exception, for its Division of Local Government publishes an annual report setting

forth the financial position of all counties and municipalities and in addition, issues a monthly newsletter dealing with new statutes, budgets, financial organization and other matters of interest to local officials.

In Britain the central departments have employed an administrative device which does not appear to have been utilized elsewhere, at least to any appreciable extent. Local authorities are required by statute to prepare comprehensive schemes or proposals for the development or administration of particular services for submission to the proper central department for approval. When approved such schemes become the basis for future local action. Thus the Education Act of 1944 requires each local education authority to prepare and submit to the Minister of Education a development plan based on the immediate and long-range educational needs of its area.[15]) The central department can, after consulting with the authority, modify any scheme submitted and approve it, the Minister being required to make a local education order giving statutory force to the development plan. This results in the fusing of central and local ideas concerning the most desirable course of action; it also affords the central ministry an opportunity to insure the observance of minimum administrative and technical standards.

Central governments in each country rely upon the services of inspectors to implement their efforts to supervise and control the affairs of local governments. While it is true that the inspectors' duties customarily cover a wide range of activities, the work of the inspectorates is uniquely important in connection with local financial activities. Inspectors do not merely confine their efforts to ascertaining whether the work in the local units is being performed in conformity with the central statutes, regulations and approved plans. More essentially their role is a positive and dynamic one. They act as missionaries of good administrative practice, seeking to aid the local authorities through advice and technical assistance. As field representatives they interpret central requirements and assist in preparing plans and adjusting local programs to central requirements.

Central inspection has reached its greatest development in Great Britain. It is at present utilized in connection with local education, health, housing, planning, highway, police and fire service activities, all of which are supported by central subventions.[16]) Inspection

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[15]) *Great Britain Statutes, 1944,* 7 and 8 Geo. VI, c. 31, sec. 11, pp. 6—8.

[16]) A detailed treatment of British central inspection will be found in the author's forthcoming book, *British Government Inspection As A Dynamic Process; The Local Services and the Central Departments* (New York: Frederick

of local education authorities by the Ministry of Education is by far the most comprehensive and is conducted continuously by a large staff of specialists. In the Canadian provinces, inspection of local fiscal affairs is employed to some extent by municipal affairs departments in several of the provinces and by departments of education in all of them. Inspection services are maintained in many American states by departments of education, welfare and health, but only in a few instances do state fiscal agencies send inspectors or field representatives to work with local governments.

CONCLUSION

Of the countries here considered, Britain has developed the most comprehensive and complete system of supervision and control of local financial affairs. In Britain most of the administrative devices described have been utilized, not as independent and uncoordinated efforts, but as part of a well-thought-out and for the most part balanced program. Emphasis is placed upon the positive and dynamic aspects of central supervision, the negative control elements being subordinated to a large extent. An effort is made to secure the adoption of minimum standards of administrative competence, and local authorities are encouraged to experiment and to pioneer in ways of their own choice and as their needs dictate. British central departments in supervising and guiding local governments place particular reliance upon the central audit of local accounts, supervision of local debt administration, scrutiny and approval of comprehensive schemes and proposals, and inspection of local services; Whitehall authorities frequently require local officials to submit periodic or special reports and statistical returns and whenever possible seek to influence local public opinion in conformity with central policy and objectives.

The American system, in contrast with that of the British, is largely uncoordinated and except in a few instances has developed on a piecemeal basis. Unification of financial administrative supervision is substantially achieved in only a few states, with New Jersey a notable example. Frequently control and supervision are applicable to only a few classes of local governments rather than to the financial activities of all local authorities within a state. Sometimes only one or two financial functions are dealt with and the remaining ones are left without the benefit of central guidance.

A. Praeger, Inc., 1956); see also John S. Harris, "Central Government Inspection of Local Services in Britain, "*Public Administration Review*, 26—34 (Winter, 1955).

The interrelationship between fiscal processes is often ignored, accounting and budgeting being separated or budgeting and debt control exercised by different state agencies.

In the United States, to an extent somewhat greater than in Britain, emphasis tends to be placed upon the maintenance of fiscal economy on the local level and the integrity of money transactions. The states in most instances have concentrated their efforts upon securing locally the adoption of minimum standards, controlling or prohibiting specific local practices, and dealing with emergency situations. The emphasis is all too often upon curtailment and control rather than upon persuasion, education, and stimulation. Thus the administrative methods most frequently utilized include the prescription of local accounts and record systems, supervision of local financial reports, auditing of accounts, control of local budgets and expenditures, and supervision of local debt management.

The type of supervision found in the Canadian provinces is somewhat more positive and persuasive than in most American states. Reliance is on the whole upon a somewhat different set of administrative techniques — central approval of money by-laws, supervision of debt administration, control of property assessment, prescription of the qualifications of local finance officers, and inspection.

In none of the countries surveyed does one find a unified organization embracing all types of financial supervision exercised by a central government. A strong case can be made for the establishment within the states and provinces, of a single administrative department, professionally staffed, to guide and supervise local financial affairs. The integration of the functional departments — health, housing, welfare, highways, and education — with the work of the single central department dealing primarily with local finance constitutes a problem for which there is no easy solution. Perhaps the most satisfactory arrangement lies in concentrating within the central agency general supervision over all local fiscal affairs and permitting the functional agencies to supplement this control in each field with more detailed and specific action. On the other hand, in a country like Britain, where the central government deals with such a large number of local governments whose responsibilities are so diverse and extensive, the wisdom of creating a single central supervisory department is open to serious question. The difficulties of securing coordination and effective overall planning, however, remain.

Viewing the entire range of powers entrusted to central governments, one is struck by the fact that two important areas of local financial administration have been almost completely neglected —

procurement of supplies and equipment and their storage, and the collection of local taxes and other revenues. Consideration could be given to the possibility of establishing regulations governing local procurement and storage, issuing manuals of procedure, rendering professional advice, and making available information concerning market trends, sources of supply, and other matters. Supervision of local tax collections conceivably could include prescription of local procedures, submission of reports, field audit of local collection accounts, and the rendering of professional counsel.

There are several techniques employed at present only to a limited extent which are of particular interest and which if their utilization were desired could add much to the existing systems of supervision. These include: (1) approval of local by-laws or ordinances dealing with revenues, expenditures, debt, and other fiscal matters; (2) central supervision of local property assessment; (3) maintenance of personnel standards for local fiscal departments concerned with such matters as employment, compensation, promotion, and retirement; (4) central approval of extensive long-range schemes or plans covering a variety of local services.

LA SURVEILLANCE DES FINANCES LOCALES PAR LE POUVOIR CENTRAL — ETUDE COMPARATIVE

par le Professeur John S. Harris

RÉSUMÉ

Les autorités locales sont rarement autorisées à exercer leurs fonctions sans un contrôle sévère de leurs finances par le pouvoir supérieur. Trois pays ont été choisis dans cette étude comparée: la Grande-Bretagne, qui a une organisation gouvernementale unitaire et dont les départements centraux surveillent directement les autorités locales, et, d'autre part les Etats-Unis ainsi que le Canada, possédant tous deux des systèmes fédéraux où la surveillance locale incombe aux autorités de l'Etat ou de province.

Les méthodes administratives des pouvoirs centraux dans leur surveillance des finances locales peuvent être classées d'après leurs buts sous deux rubriques générales:

1) celles qui sont plutôt restrictives par nature et dont le but est de réduire au minimum les programmes, ou bien de surveiller ou d'interdire des activités locales déterminées; 2) des techniques de surveillance propes à encourager les pouvoirs locaux à faire plus que le minimum, à développer leurs systèmes financiers en fonction de leurs besoins spécifiques et à encourager les expériences et l'initiative locales. Les méthodes plutôt restrictives se caractérisent par l'obligation d'une comptabilité locale et de systèmes de recours aux départements centraux, la surveillance de la préparation des rapports sur les finances locales, l'examen par le pouvoir central de comptabilités locales, le contrôle des budgets et des dépenses locales, la surveillance de l'administration de la dette locale, le contrôle du recrutement et de la destitution des fonctionnaires des finances locales et la surveillance de la gestion du domaine public locale. Dans le second groupe — celui qui voudrait avant tout persuader, stimuler, éduquer les pouvoirs locaux — on trouve le rassemblement et la distribution par les départements centraux de données statistiques et d'autres renseignements, l'approbation par les bureaux centraux de vastes projets ou propositions concernant l'extension ou l'administration de services locaux déterminés, enfin, l'inspection par le pouvoir central des programmes de l'autorité locale.

Parmi les trois pays considérés ici, la Grande-Bretagne a développé le système le plus vaste et le plus complet de surveillance et de contrôle. En Grande-Bretagne, la plupart des procédés administratifs exposés ont été mis en oeuvre, non comme des efforts indépendants et non coordonnés, mais comme éléments d'un program-

me bien pensé et en majeure partie équilibré. L'accent est mis sur les aspects positifs et dynamiques de la surveillance centrale, les éléments négatifs du contrôle étant réduits au strict minimum.

Un effort est fait pour assurer l'adoption de normes minima de compétence administrative et les autorités locales sont encouragées à faire des expériences et des recherches dans des directions de leur propre choix et suivant les exigences de leurs besoins. Les départements centraux britanniques, dans la surveillance et la direction des pouvoirs locaux, attachent une importance spéciale à l'examen, à l'échelon central, des comptes locaux, à la surveillance de l'examen de la dette locale, à la mise au scrutin et à l'approbation de programmes et de projets étendus et à l'inspection des services locaux. Les autorités de Whitehall demandent souvent aux bureaux locaux de leur soumettre des rapports périodiques ou spéciaux et des statistiques; elles cherchent aussi, chaque fois que possible, à influencer l'opinion publique locale conformément à la politique et aux objectifs du pouvoir central.

Le système américain, contrairement à celui de la Grande-Bretagne, manque grandement de coordination et, sauf en quelques cas, il s'est développé par bribes et morceaux. L'unification de la surveillance administrative financière n'est en substance complète que dans quelques Etats, le New-Jersey étant un remarquable exemple. Fréquemment le contrôle et la surveillance ne sont applicables qu'à un petit nombre de pouvoirs locaux plutôt qu'à toutes les activités financières de toutes les autorités locales dans un Etat. Parfois, seule une ou deux activités financières retiennent l'attention et les autres restent dépourvues du bénéfices de directives centrales.

Aux Etats-Unis, dans une mesure un peu plus grande qu'en Grande-Bretagne, l'accent tend à être mis sur le maintien de la fiscalité locale et sur l'intégrité des transactions monétaires. Les Etats ont, dans la plupart des cas, concentré leurs efforts en vue d'assurer localement l'adoption de normes minima en matière de surveillance ou d'interdiction de pratiques locales déterminées et, enfin, pour la solution de situations critiques. L'accent est mis trop souvent sur la restriction et la surveillance plutôt que sur la persuasion, l'éducation et l'encouragement. Les méthodes administratives le plus souvent utilisées sont donc la prescription de divers systémes locaux comptables et d'enregistrement, la supervision des rapports financiers locaux, l'examen des comptes, le contrôle des budgets et dépenses locaux et la surveillance de l'administration de la dette locale.

Le genre de surveillance qu'on utilise dans les provinces canadiennes est légèrement plus positif et plus persuasif que dans la plupart des Etats américains. La surveillance s'exerce dans l'ensemble,

selon un système quelque peu différent de techniques administratives — l'approbation centrale des lois monétaires accessoires, la surveillance de l'administration de la cette, le contrôle des impôts sur la propriété, la détermination des qualités requises des fonctionnaires des finances locales, et l'inspection.

En considérant toute l'étendue des pouvoirs confiés aux autorités centrales, on est frappé du fait que deux domaines importants de l'administration des finances locales ont été généralement tout à fait négligés: l'approvisionnement en fournitures et équipement ainsi que leur entreposage, d'autre part la levée des taxes locales et des autres ressources.

FULL EMPLOYMENT, INFLATION AND ECONOMIC POLICY*)

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Governments have, with the general acceptance of Keynesian economics, assumed responsibility for the economic well-being of the community, and through public finance and their fiscal and monetary policies they have become, for better or for worse, the main determinant of the state of the economy. This is common knowledge; but there is still much uncertainty, in both public and official circles, about the scope of governmental economic responsibility, and the precise meanings of the economic concepts relevant to the implementation of this responsibility. Concentrating on the short-run economic objectives of government, this essay is mainly concerned with showing that satisfactory economic policy is only possible if full employment is defined in such a way as to include the inflationary potentials of different levels of employment.

Governmental economic policy may be defined as the establishment and maintenance of a well-balanced progressive economy. The long-run objectives of policy are concerned with raising the standard of living through the more productive utilization of given resources, and by adding to those resources. These objectives require the acquisition of knowledge, the development and application of new techniques, and the installation of new and better capital equipment. The pace of growth may be accelerated by the elimination of restrictive monopolistic practices of both labour and business. Economic progress, especially at an appropriate rate, is not an automatic process; it should be the concern of policy and necessitates initiative, enterprise and inventiveness. For a country such as Britain, economic progress should at least keep pace with that experienced by her main rivals in international trade.

The main short-run economic objectives are the maintenance of full employment, the prevention of inflation, and the avoidance of balance of payments deficits. The expression 'balance of payments deficit' is used for simplicity. With regard to the United Kingdom, policy should probably be concerned with establishing a *surplus* on

*) The analysis is concerned with the United Kingdom, but it is also relevant to other comparable advanced economies. It is not, however, without substantial modifications, relevant to the economies of the overpopulated and underdeveloped nations of the East.

the balance of payments Current account of, say £200/300 million per annum, in order to strengthen Commonwealth political and economic ties through investment, and to finance an increase in the gold and dollar reserves. In this case, a smaller surplus would be an unsatisfactory outcome of overseas transactions. But this would hardly warrant alarm or justify drastic corrective action. An actual deficit, however, is a threat to the nation's gold and foreign currency reserves and to the strength of sterling, and if large and persistent must produce an economic crisis necessitating corrective action.

Much controversy exists on the precise meanings of full employment and inflation. In the present context inflation means that total monetary outlay is rising at a faster rate than the output of goods and services valued at current prices. In wartime it is proper and feasible to suppress inflation through price controls and rationing. But at other times suppressed inflation, as is well known, produces other symtoms of inflation in the forms of disproportionate incomes and rising prices in the uncontrolled sectors of the economy, leading to maldistribution of resources and black and grey markets. In the absence of price controls and rationing all prices tend to rise and, initially, the inflationary pressures are reduced. But inflation produces a process of change rather than a once and for all adjustment. Since many products are intermediate products to other producers, rising prices mean rising costs followed by more rising prices. Similarly, if the real earnings of labour are to be maintained, wages must rise as prices rise, producing the familiar inflationary spiral.

A variety of measures have been tried in post-war Britain from rationing and price controls to credit squeezes, but as yet no cure for the malady has been found. There is, of course, no secret about the cure: either supply must increase with no corresponding increase in money earnings, or total monetary demand must be reduced. Total monetary demand can be reduced through i) an increase in savings, ii) confiscation of income by taxation, iii) specific measures to reduce consumption and/or investment expenditures, iv) reduced governmental expenditure, or a combination of these measures.

It is sometimes argued that even in the short-run, with new methods of production, large increases in output could be secured from the available resources. But changing the methods of production is a long-run objective. In the short-run, scarcity of resources places a limit on supply. To increase supply requires an increase in productivity, i.e. an increase in output from given resouces, and the installation of capital equipment which produces a larger output with existing co-operating factors. But the installation of capital equipment takes time, utilizes resources and generates money incomes and is, therefore, inflationary unless there is an equivalent increase in

savings through reduced personal consumption or governmental expenditure. Contemporary experience shows, however, that there is plenty of scope for increases in productivity through changed methods of production and the elimination of restrictive practices. But such changes require a new and enlightened attitude of labour towards industrial and economic problems, and improvements in the arts of management. It may be possible to speed up the adoption of new methods and techniques, through education of labour and management, but any resulting improvements can hardly solve an immediate inflationary problem. In the short-run, then, disinflation requires a reduction of total monetary outlay.

Inflation of the post-war variety is not, however, independent of the level of employment. To this we now turn. A satisfactory definition of full employment is not easily found. Indeed there is great need for new thinking on the subject and the introduction of new terminology. It is misleading to use the expression *full* employment to describe a situation in which recorded unemployment is not zero. In both theory and experience there can be no doubt that *under* and *over* employment can exist. Over employment has been witnessed by all, and under employment by those whose memories stretch back to pre-war years. These conditions are easily identifiable, but so far the *precise* theoretical and quantitative expressions of such conditions, and hence of the desirable optimum level between them, have eluded economists. This may be illustrated as follows.

Assuming the existence of under employment of men and equipment, a policy of *reflation* is called for. An increase in total monetary demand will generate incomes and employment, through higher sales and increased production. At first, increased monetary outlay will cause a more than proportionate increase in output and employment, because of a) increased output by producers in anticipation of further increases in demand and to bring their stocks to a higher level appropriate to the expected higher sales and turnover, and b) the more productive combination of fixed and variable factors as the level of employment rises. As total monetary outlay increases and the level of employment grows, diminishing returns (i.e. increasing cost per unit of output) set in, because a) given the process of production, the optimum combination of fixed and variable factors is passed, b) some factors of production become scarce so that their supply prices rise, and c) less efficient (more costly in terms of output) labour finds employment. Any further increase in total monetary outlay would still cause total output and employment to rise, but the rise would be less than proportionate to the

rise in monetary demand. At this stage inflationary pressures emerge and the optimum level of employment is reached. This optimum level, however, may vary depending on i) whether a higher level of employment with a higher rise in prices is preferred to a lower level of employment with a lower rise in prices, or no rise in prices at all, and ii) what has been called the wages-price structure or relationship. [1]) With regard to the choice between different levels of employment, so long as a) the balance of payments position is satisfactory, and b) forces conducive to the promotion of economic growth and progress are operative, it may seem wasteful to forgo increased output and employment in order to prevent a moderate degree of inflation. If policy were based on this view, it ought to be possible to devise a scheme for compensating those sections of the community whose real incomes fall as prices rise. On the wages-price structure, there is urgent need for economic research. All that can be said in this context is that with high levels of employment monopoly elements become important, both in organised labour and in business. If labour tries to secure wage increases in excess of that justified by increased productivity, and if businessmen try to pass on increased costs in the form of higher prices or try to secure higher profits through higher prices, the higher will be the inflationary potential of a given level of employment. Finally, increases in total monetary outlay beyond the point of optimum employment will have some effect on the level of employment and rather less on total output, but the main impact of rising demand will be on prices. The situation is then one of inflation and over employment.

So much for the theory. In practice, in Britain, full employment has come to mean a situation in which vacancies exceed available men. Much has already been written on the dangers of this condition and there is little doubt that it indicates a state of over employment, with inflation as an inevitable by-product and recurrent balance of payments crises as ever present dangers. An excess demand for most final products inevitably produces an excess demand for economic resources. Supplies, both in product and factor markets, lag behind demand and prices rise. Competition for labour drives up wages, and organised labour would be surprisingly lacking in monopolistic behaviour if it failed to make the most of its opportunities of self-gain. The normal rule that a monopoly can control *either* quantity *or* price is no longer operative, so far as trade unions

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[1]) For a brief but thought-provoking reference to wage-price structures, see The Separate Concurring Statement by J. M. Clark, in National and International Measures for Full Employment, United Nations, 1949.

are concerned. With over employment, the level of employment can be ignored by trade unions and their policies can concentrate on wages, conditions and non-pecuniary benefits. It is, in these conditions, relatively easy for labour to secure wage increases in excess of those justified by increased productivity, so that cost induced inflation emerges. The higher demand price for labour and the higher supply price fixed by trade unions, together drive up costs, which in turn are passed on to the consumer in higher prices. The situation is still further aggravated when wage claims are made to preserve conventional wage differentials. Wage differentials, reflecting differences in required skills and training are very necessary in order to provide incentive for their acquisition. But if a successful wage claim is automatically to be followed by wage claims from other trade unions to preserve conventional wage differentials, with no regard to productivity at all, then a new and dangerous inflationary spiral has to be contended with.

In an inflationary situation the threat to the balance of payments arises through an increased demand for imports as incomes rise, and the diversion of exportable goods to the home market. In addition, exports will fall, or rise less rapidly than imports, if the pace of inflation exceeds that experienced by competitors abroad. Even if the higher prices of exports are not serious deterrents, any tendency to reduced quality and lengthening of delivery dates will seriously retard exports. Moreover, though the balance of payments appears to be satisfactory, it is possible that inflation at home exceeding that experienced by competitors may result in the rate of growth of exports being less than that realised by rivals. In this event Britain's share of the world markets is reduced.

If an excess of jobs over available men, i.e. a sellers' market, is a condition of over employment, can full or optimum employment be defined in terms of an equal number of jobs and available men? This is frequently contended, but the contention is not free from criticism. The condition implies a larger annual average number of the total labour force being registered as unemployed. Fewer jobs will be available in the same industries in the same localities as the available men; hence jobs will have to be found and men will have to move to them. The 'between jobs' type of unemployment will last longer, and this alone will cause an increase in the unemployment average. This, however, may be offset to some extent by a reduction in the number of men who walk out of jobs for near frivolous reasons, when jobs are too plentiful. But if labour, through its monopoly power, secured wage increases in excess of any increased value of total output, an inflationary condition would arise. This could

change the labour market into a sellers' market and produce the results already discussed. A further possibility is that trade unions might secure wage increases at the expense of employment. If governments were then expected to provide vacancies for the available men, monetary demand would have to be increased and inflationary conditions would emerge.

Another popular approach defines full employment in terms of a percentage of the total labour force. In a progressive economy as a result of changing tastes and innovations the pattern of production is constantly changing. This necessitates a redistribution of productive resources. Men and resources must move from contracting to expanding industries. This change takes time and inevitably involves some recorded unemployment. In addition, at various times, there will be some seasonal unemployment.

Five economists engaged by the Secretary General of the United Nations, in a report on the national and international measures for full employment, suggested that the unavoidable unemployment may be between 2% and 4% of the working population. In estimating the percentage in employment, the report suggests that an allowance should be made for the full time unemployment equivalent of time lost by workers on short time but who are able and willing to work full time. But the report says nothing about making allowances for overtime work. This is a curious omission. When high levels of total monetary demand are still rising, not only does the effective size of the labour force increase through the entry of married women and the postponement of retirement, but employment also rises through increased overtime. This has importance both with regard to the measurement of the level of employment and the inflationary potential of that level. The higher the level of employment the greater the amount of overtime being worked. A proper allowance for this overtime would make a substantial difference to the percentage level of employment. Given the standard week it is not inconceivable for employment levels to exceed 100% of the working population when adjustments are made for overtime. This must certainly be true of Britain where recorded unemployment has recently been less than one per cent. It would appear that definitions of full employment as a percentage of the total labour force are misleading, not unambiguous, and potentially dangerous if economic policy is stated in terms of establishing a very high percentage.

The dangers are both economic and political. It is apparent from the forgoing that the higher the percentage employment target, the greater the probability of inflation and balance of payments difficulties, since a given percentage is not an unambiguous measure of

actual employment. But once a high percentage has been established, with only mild or zero adverse effects, it is likely that both the public and politicians will expect that level to be maintained, or even increased. The dangers lie in the general acceptance of a specific percentage employment level as a *correct* one. Clearly, the inflationary potential of, say, 98% with no overtime is quite different from that of 98% with widespread overtime. Moreover, the longer the high level of employment exists the greater the inflationary potential resulting from the more extensive use of monopoly powers by labour and business. This seems a natural consequence of confidence and boldness engendered by a sense of permanence. But once a community has become convinced of the rightness of a specific high level of employment, which can only too easily become inconsistent with the pursuit of other economic objectives, there is a real risk that politicians will concern themselves with "curing" symptoms instead of causes, either through ignorance or self-interest. So long as there is no actual balance of payments crisis it is easier to condone or ignore inflation than to court political unpopularity.

Further difficulties arise from the fact that, say, an average employment level of 98% of the total labour force, may, in *actual numbers employed* in period one, be different from the average 98% of the total labour force in period two. This implies, of course, that the size of the total labour force has changed. Changes in the size of the labour force are due to the net difference between the reductions caused by emigration, deaths, and retirements by pensioners and married women, and the increases caused by immigration, entry of youths and married women, and the postponement of retirement. To make the point it may be better to concentrate on the 2% unemployment. If the size of the labour force has fallen by period two, then 2% of the total is a smaller absolute number. In this case some of the unemployed will have to be found jobs. This may not be easy when the number unemployed is already small. It may also be undesirable since the fall in the size of the labour force may be due to disinflationary pressures causing an efflux of married women and pensioners. In the reverse case, when the total labour force expands, 2% represents a larger number of unemployed. Either some people must be deprived of jobs or the percentage unemployment must be allowed to fall. In the latter event the employment level becomes greater than 98 per cent. This is the kind of situation which has occurred in post-war Britain. The labour force has shown a remarkable capacity for expansion. The absolute number of unemployed has fallen, but the fall in its percentage value has mainly been due to the increase in the size of the total labour force. This expansion in the labour force is probably only a tempor-

ary phenomenon, consisting very largely of married women who have been able to find jobs because of the excess demand for most resources. Indeed, this expansion of the labour force provides a useful measure of the excess demand. When the size of the labour force can increase by an amount several times greater than the average unemployment recorded during that year, it is evident that over employment exists, with vancancies exceeding the unemployed.

These then are some of the problems and difficulties associated with the concept of full employment. How then should full (or better optimum) employment be defined? Full or optimum employment is that level of employment which can be established by increasing monetary demand without causing inflation or balance of payments difficulties. It may, as was mentioned earlier, be considered desirable to modify this definition to include moderate inflation if i) balance of payments difficulties are absent, and ii) the avoidance of inflation involves unemployment substantially in excess of that necessary to economic progress. But in this event, fiscal policy should incorporate compensatory measures to reduce or eliminate the adverse effects of even mild inflation for fixed income groups. It must also be emphasized that the modified definition is dangerous as a governmental economic objective, unless or until a formula has been found for preventing the abuse of monopoly power by labour and business.

Finally, this definition of optimum employment implies that the authorities can distinguish between those adverse effects due to the level of employment and those arising from other causes. Obviously, pressures on prices (e.g. increased prices of imports) and balance of payments difficulties (e.g. a fall in exports due to economic contraction abroad) can exist for reasons other than the level of employment. But post-war British experience confirms that if total monetary demand is pushed too far, a condition of over employment results, with cost induced inflation almost inevitable and balance of payments crises ever present dangers.

Postscript on the Government's White Paper (Cmd 9725) The Economic Implications Of Full Employment.

The need for an official document on this topic was widely felt, but since its publication much doubt has been expressed on whether the White Paper adequately meets the need. The doubts have been concerned not so much with what the Paper says as with how it says it, and with what it fails to say. The Times, for instance, while conceding "the delicacy of the subject" clearly thinks the Paper is lacking in "sturdy realism", speaks "timidly and in muffled voice", and "is too reticent to make the necessary points clearly". On the side of omissions commentators have been quick to observe that the Paper might have said more on policy intentions, on the effectiveness of past measures, on the concept of full employment, and on what measures would be necessary if exhortation, as expected by the commentators, proves ineffective.

The Paper begins with ambiguity through its failure to define or discuss the concept of full employment. This, one might think, was indispensable to an analysis of the *implications,* economic or otherwise, of full employment. In its opening paragraph, the White Paper states that "full employment has been maintained in most parts of the country for most of the past ten years, but it "has brought with it one problem to which we have no yet found a satisfactory solution"; the problem of "continually rising prices". But what *level* of employment is here indentified as *full* and why is it identified as full? Obviously there is a connection between high levels of employment and inflation, but it seems unwise, and not logical, to identify the several levels of employment experienced in Britain in post-war years with full employment, and then conclude that full employment has given rise to inflation. This type of approach is not conducive to adequate analysis or clear thinking about either concepts or problems. The more logical approach in terms of British experience, we suggest, would present the facts about the post-war high levels of employment and inflation, analyse the connection between the two and the economic implications of different levels of employment, with the object of clarifying the concept of full employment as an objective of governmental economic policy. It is difficult to see how any clear analysis of the economic implications of full employment can be expected to emerge from an analysis which is not first clear on the meaning of full employment.

Nevertheless, the White Paper gets very close to our own definition of full or optimum employment. In paragraph 25 (p. 10) is

stated that the Government must "seek to ensure that the pressure of domestic demand does not reach a level at which it threatens price stability and endangers the balance of payments. To maintain full employment without inflation necessarily involves continual adjustments. At times the pressure of demand will grow too strong and will need curbing; at other times this pressure will be weak, and the economy will need a stimulus. It is the Government's job to keep the pressure right..." This is the crux of the matter but unfortunately these notions are not developed and no attempt is made to express the critical levels in precise theoretical or quantitative terms.

The White Paper contains a useful statistical exercise on the extent of inflation in Britain during the past decade and apportions "blame" between rising cost of imports, changes in subsidies and indirect taxes, and rising wages, salaries and profits, and finds the latter group the villain of the piece. They, labour and businessmen, are the villains because they exploit full employment prosperity, so that full employment and price stability become incompatible. The White Paper calls this a dilemma and sees the only solution in "self-restraint in making wage claims and fixing profit margins and prices, so that total money income rises no faster than total output". This is indeed a real danger, but the danger is more apparent when conditions of over employment exist. The higher the level of employment the greater the dangers of monopoly exploitation. But it hardly seems feasible for economic policy to work on the assumption that monopoly practices can be significantly reduced through official exhortations. With high levels of employment all market forces work in the opposite direction. Unless, as already argued, a formula can be worked out for preventing the adverse effects of monopoly powers, the Government cannot escape from its responsibility for reducing monetary demand by that amount which makes both sides of industry once again conscious that their policies must take into account *quantity* as well as price.

The White Paper makes many sound observations on economic progress, the need for investment and increased productivity, and the need for a surplus on the balance of payments on current account in order to replenish gold and currency reserves and to finance overseas investment. But it is silent on the subject of unemployment: not unnaturally in view of the Paper's lack of precision on full employment, in either theoretical or quantitative terms. But it is precisely this problem which needs clarification. Some unemployment is inevitable and some is necessary in the interest of economic growth and progress. It may not be possible, as yet, to define this

level satisfactorily, in either theoretical or quantitative terms, but silence on the subject is no helpful. Inflation links all the White Paper's considerations, but the Paper fails to reveal in any specific way the connections between inflation, employment levels, monopoly elements, the balance of payments, and economic policy.

The White Paper concludes with the same ambiguity with which it started. "The experience of the past ten years has shown that the fuller employment is the more liable prices are to rise; but the Government does not believe that there is any inevitable conflict between the two objectives." Certainly the higher the level of employment the more liable prices are to rise, but it is necessary to explain which of the several levels included in the range of *fuller* is to be regarded as the *full* employment to be aimed at by the Government Clearly, some of the *fuller* levels are over employment levels which *are* incompatible with the avoidance of inflation, and other desirable economic objectives as well.

NOTE: This essay was written shortly before the publication of the Government's White Paper. Some duplication is inevitable; but in the main our argument is complementary to that of the White Paper, and no revision appeared to be necessary.

LE PLEIN-EMPLOI, L'INFLATION ET LA POLITIQUE ECONOMIQUE

par le Professeur H. Burton

RÉSUMÉ

L'acceptation générale de l'économie keynesienne a eu comme résultat que les gouvernements sont responsables du bien-être économique de la communauté, déterminant essentiellement l'état de l'économie, mais il y a une grande incertitude en ce qui concerne l'étendue de cette responsabilité et le sens exact des concepts se rapportant à sa mise en oeuvre. La politique économique du gouvernement peut être divisée en des objectifs à longue et à courte durée; celles à longue durée concernent la croissance et le progrès économique, celles à courte durée le maintien du plein-emploi, la prévention de l'inflation et des difficultés à sujet de la balance des paiements. Cette étude vise principalement à montrer que les objectifs à courte durée ne sont compatibles que lorsque le plein-emploi comprend par définition les potentiels inflatoires des différents niveaux d'emploi, et lorsque on se réalise parfaitement les différents effets défavorables d'un pouvoir monopolisant associés aux différents niveaux d'emploi.

On définit l'inflation comme une situation dans laquelle la dépense monétaire augmente à une vitesse plus grande que la production courante évaluée aux prix en vigueur. Les prix en hausse exercent d'abord une influence stabilisatrice mais l'inflation produit un procès de changement plutôt qu'un ajustement définitif. Lorsque les prix sont en hausse les frais augmentent, ce qui entraîne une nouvelle hausse des prix; la spirale d'inflation bien-connue. Il y a tout lieu d'accroître la productivité ce qui pourrait améliorer une situation inflatoire, mais l'augmentation de la productivité constitue un objectif à longue durée et ne pourrait pas résoudre un problème inflatoire immédiat. A bref délai la demande monétaire totale doit être réduite par (i) des épargnes augmentées, (ii) la confiscation de revenus par la taxation, (iii) des mesures spéciales pour réduire les dépenses de consommation et d'investissement des particuliers, (iv) réduction des dépense gouvernementales, ou une combinaison de ces mesures.

Il n'est pas facile de trouver une définition satisfaisante du plein-emploi. En théorie aussi bien qu'en pratique il peut y avoir le *sous*-emploi ou le *sur*-emploi. Ces conditions peuvent facilement être identifiées, mais jusqu'ici l'expression théorique et quantitative pré-

cise de telles conditions, et de là le meilleur niveau entre les deux, ont échappé aux économistes. Conformément à l'analyse économique acceptée généralement dans des conditions de sous-emploi, une politique de reflation fera accroître le rendement et l'emploi sans occasionner une hausse des prix. Mais le temps viendra où l'accroissement du rendement et de l'emploi diminue dans un degré qui est toujours moins proportionné à la hausse des dépenses monétaires. Des pressions inflatoires émergent et le niveau optimum d'emploi est atteint. Toutefois, cet optimum varie selon le degré de pouvoir monopoliste exercé par les organisations syndicales ouvrières et de commerçants. Un niveau plus élevé d'emploi avec une inflation moyenne peut être qualifié de „plein emploi" si (i) la situation de la balance des paiements est satisfaisante, (ii) des forces entrent en jeu qui favorisent la croissance et le progrès économique, (iii) l'abus d'un pouvoir monopoliste peut être empêché, et (iv) des mesures sont introduites pour que les personnes qui reçoivent un revenu fixe soient indemnisées de la perte de revenu réel. Les augmentations des dépenses monétaires au delà du niveau de l'emploi optimum auront un certain effet sur le niveau d'emploi (et sur le volume de la main d'oeuvre), et une influence bien plus faible sur le rendement, mais les prix subiront un effet beaucoup plus grand. Ceci représenterait une situation de sur-emploi.

Le plein-emploi défini comme situation où les places vacantes sont en excès sur les hommes disponibles.

C'est là le sens qu'a obtenu le plein-emploi au Royaume Uni: c'est un état de sur-emploi avec l'inflation comme le sous-produit inévitable. Des tendances du marché produisent une augmentation du prix de l'emploi demandé aussi bien que de l'emploi offert, et la règle normale que les monopolistes peuvent contrôler *soit* la quantité *soit* le prix, mais non pas les deux, cesse d'être vrai. Les syndicats peuvent concentrer tous leurs efforts sur la hausse des salaires et l'amélioration des conditions et des avantages non-pécuniaires. Les salaires augmentent plus rapidement que ne serait justifié par une productivité accrue et il se produit l'inflation provoquée par la majoration des frais. La situation s'aggrave davantage lorsque les revendications de salaire sont formulées pour maintenir les différentiels conventionnels de salaire. Des revendications de salaire couronnées de succès amènent de nouvelles revendications par d'autres syndicats et il faudra faire face à une nouvelle et dangereuse spirale inflatoire.

Le plein-emploi défini comme situation où les places vacantes sont égales au nombre d'hommes disponibles.

C'est aussi une définition peu satisfaisante. Si les syndicats réussissent à obtenir des salaires plus hauts que la valeur accrue du rendement courant, il en résulte très vraisemblablement une demande excessive et l'inflation. Les syndicats pourraient aussi obtenir des salaires plus élevés aux dépens de l'emploi. Si les gouvernements devaient alors trouver du travail pour les nouveaux chômeurs, la demande monétaire devrait être augmentée et des conditions inflatoires se présenteraient.

Le plein-emploi exprimé comme un pourcentage de la main d'oeuvre totale.

De telles définitions sont trompeuses, non sans ambiguïté et très dangereuses si la politique économique est exprimée en termes d'un pourcentage très élevé. En tenant compte du travail hors d'heures, les niveaux d'emploi peuvent dépasser les 100 % de la main d'oeuvre disponible. Les dangers résident dans l'acceptation générale d'un pourcentage *spécifique* élevé comme étant correcte. Le potentiel inflatoire de, mettons, 98 %, sans heures supplémentaires, est sensiblement différent de celui de 98 % comprenant une large portion d'heures supplémentaires. En outre, plus longtemps le niveau élevé d'emploi existe, plus important sera le potentiel inflatoire par suite de l'exploitation plus poussée des pouvoirs monopolistes par les syndicats ouvriers et commerciaux. Ceci semble être une conséquence naturelle de confiance et de hardiesse produite par un sentiment de permanence.

Alors, comment faudrait-il définir le plein-emploi. La définition suggérée dit que le plein-emploi constitue un niveau d'emploi que l'on peut établir en augmentant la demande monétaire sans entraîner une inflation ou des difficultés de la balance des paiements. La définition peut être modifée et comprendre une inflation modérée si (i) il ne se présente pas de difficultés par rapport à la balance des paiements, et (ii) le fait d'éviter l'inflation entraîne le non-emploi dans un degré substantiellement plus haut que celui nécessaire pour le progrès économique. Cependant, la définition modifiée est dangereuse comme objectif économique du gouvernement jusqu'à ce qu'on ait trouvé une formule pour empêcher l'abus de pouvoir monopoliste par les syndicats ouvriers et commerciaux.

Postcriptum sur le Livre Blanc du Gouvernement (Cmd 9725)

Les implications économiques du plein-emploi.

Le Livre Blanc ne produit pas l'effet désiré parce qu'il ne définit

ni ne discute le plein-emploi comme un concept. Rien n'est dit au sujet du non-emploi. Il n'est, peut-être, pas encore possible de définir le niveau nécessaire du non-emploi d'une manière satisfaisante soit en termes théoriques soit en termes quantitatives, mais le silence ne nous avance pas. L'inflation relie toutes les considérations du Livre Blanc, mais le livre manque de faire connaître en aucune façon spécifique les relations entre l'inflation, les niveaux d'emploi, les éléments monopolistes, la balance des paiements, et la politique économique.

A un certain point (paragraphe 25, page 10) le Livre Blanc n'est pas loin de „prendre le taureau par les cornes", lorsqu'il est dit que le Gouvernement doit „chercher à assurer que la pression de la demande domestique n'atteigne pas un niveau où elle menace la stabilité des prix et mette en danger la balance des paiements. Si l'on veut maintenir le plein-emploi sans inflation, des ajustements continuels sont indispensables. A certains moments la pression de la demande sera trop forte et devra être diminuée; à d'autres moments cette pression sera faible, et l'économie aura besoin d'être stimulée. C'est la tâche du Gouvernement de maintenir la bonne pression..." malheureusement ces notions n'ont pas été développées et aucun effort n'a été fait pour exprimer les niveaux critiques en termes théoriques ou quantitatives précises.

Le Livre Blanc attribue la cause de l'inflation dans les dix ans après la guerre à la hausse des salaires et des profits; les syndicats ouvriers et le commerce exploitent la prospérité du plein-emploi, de sorte que le plein-emploi et les prix stables sont incompatibles. La solution envisagée est „la modération dans les revendications des salaires et dans l'établissement des marges des profits et des prix, de sorte que le revenu total monétaire ne montera pas plus rapidement que le rendement total. Ceci semble une solution douteuse. Comme les forces du marché opèrent en sens contraire, il n'est guère probable que les pratiques monopolistes puissent être réduites sensiblement par des exhortations officielles. Il semble évident qu'à moins qu'on puisse trouver une formule pour prévenir les effets défavorables des pouvoirs monopolistes, le Gouvernement ne saurait se dégager de sa responsabilité de réduire la demande monétaire d'un tel montant que les parties des deux cotés de l'industrie se réalisent de nouveau que leurs politiques doivent considérer la *quantité* aussi bien que le prix.

BOOK REVIEWS / CRITIQUES

Prof. Maxime Chrétien, *A la recherche du droit international fiscal commun, étude de droit positif à partir de la jurisprudence des Cours internationales* (Préface du Prof. M. Batifol); Recueil Sirey, S.A., Paris (v) 1955.

Cette oeuvre est la reproduction d'une étude publiée en plusieurs fois dans une revue; personne à la lecture du livre ne soupçonnerait cependant cette particularité, si l'auteur ne l'avait signalée lui même. La conception est parfaite et présente une grande unité.

L'exposé se déroule d'une façon logique; chaque nouveau „numéro" (car l'ouvrage se compose de 237 paragraphes numérotés [1]) est une étape qui mène aux conclusions. Méthodiquement, délimitant le terrain, le subdivisant, l'auteur expose pour nous ses recherches vraiment très poussées. On y trouve d'abord quelques observations sur le droit international privé. Plus importantes et remplissant presque la moitié de son livre sont les observations sur le droit international *public*, qui est le point de départ de l'étude. Le cadre de cette dernière dépasse donc largement la seule fiscalité. Toujours s'orientant sur les grands principes du droit international public, les expliquant par de nombreux jugements des deux Cours internationales, il finit son exposé par du droit international fiscal commun, en l'espèce „les règles juridiques qui obligeraient tous les Etats en ce qui concerne les impôts". Sa connaissance encyclopédique des deux matières se montre aussi dans la clarté de ses exposés juridiques qui sont vraiment... français. Le grand nombre de précisions, spécialement sur le nombre d'adhérents à une convention de l'O.N.U., ainsi que les notes au bas de pages sur livres, articles de revue, arrêts et avis montrent le zèle avec lequel l'auteur s'est adonné à son travail. Il ne tâche pas seulement de nous persuader par son éloquence juridique, mais il se rend également compte à chaque instant du revers de la médaille, c'est-à-dire de ce qui est susceptible de contestation.

Quant au sujet même que l'auteur a choisi, il faut dire que jamais ne me serait venue l'idée qu'il existait en droit positif un droit international fiscal commun. J'appartiens donc à ceux, qui comme l'auteur dit: „n'ont jamais consacré une étude approfondie à la question" de savoir „s'il existe, dans le domaine des impôts, *certaines normes que tout Etat devrait respecter, qui seraient absolument communes*". Convaincu que j'étais avant de commencer la lecture, que la réponse serait presque négative, que tout au moins elle ne serait jamais

[1]) Dans le cours de ce compte-rendu l'indication p. renvoie aux paragraphes.

pleinement affirmative, mon opinion sur le droit concret ne diffère pas beaucoup de celle de l'auteur; mais il y arrive seulement après avoir creusé le terrain de toutes les manières possibles. La base de ses recherches est la documentation que donnent les traités et „la juridiction internationale" de la Cour internationale de Justice et de son successeur immédiat, la Cour permanente de Justice internationale (C.P.J.I.) qui forment ensemble „l'organe du droit international". Quant aux autres sources du droit international, la coutume et les principes généraux, il croit qu'on peut les négliger ou presque. C'est justement sur ce point de départ que je me permettrai quelques observations à la fin de ce compte rendu. Il critique les arrêts, jugements et avis des Cours, mais il en a tiré maints principes précieux, spécialement en matière de droit international *fiscal* ou parafiscal.

Le chapitre I est consacré à la souveraineté [2]) fiscale des Etats, notion qui constitue nécessairement le point de départ de l'étude.

Le chapitre II est consacré à l'étude des limites générales (ou quasi-générales) à cette souveraineté.

Je me rappelle que dans les années où pour la première fois il s'est agi d'accords multilatéraux sous les auspices de la S.D.N., la souveraineté des nations a été maintes fois la pièce de résistance des discussions. Il fallait du temps pour bien comprendre que „tout accord international apporte des limitations à la souveraineté" (Hymans, première convention économique à Genève, 1923: „L'Etat seul est l'unique source du droit international, (E)' [3]) (voir p. 17, 26, 113, 115). Et cela est encore vrai dans les circonstances actuelles où la souveraineté est une notion plus ou moins théorique pour maints pays, comme celle de la neutralité; mais, formellement, tout ce que l'auteur dit sur ce sujet me semble très juste. La conclusion qu'il met au premier plan, c'est que la règle la plus certaine,

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[2]) p. 11 et p. 118: Souveraineté et indépendance sont synonymes; p. 19: la souveraineté est le principe fondamental du droit international. Voir quelques observations là-dessus dans les pages suivantes. Quant à l'égalité des Etats (p. 11): il faut distinguer diverses souverainetés (souveraineté interne, le suzerain dirige les affaires étrangères). Voir aussi note 2.

[3]) Une tout petite observation: le Saint Siège et l'O.N.U. sont aussi sujets de droit international; ils sont capables d'avoir entre eux des droits et des obligations fondés sur le droit international.

Il existe aussi des communautés territoriales qui — sans être indépendantes — ont une autonomie restreinte; il leur est permis d'avoir des rapports juridiques avec des Etats indépendants (elle peuvent recevoir des diplomates, mais elles ne peuvent pas en envoyer, comme la Tunisie); elles sont donc considérées comme des personnes internationales. Les cantons suisses ont une semblable autonomie, mais quelque fois subordonnée à l'approbation du Conseil central.

Voir aussi p. 29, 108 et 109 pour l'Algérie.

à savoir la souveraineté fiscale des Etats, est la seule incontestable en droit positif, mais qu'elle est précisément celle qui est la plus contestée par une partie de la doctrine internationale.

— Tout cela paraît très simple, mais ces conclusions sont en fait le résultat de longues et difficiles recherches et d'une grande patience. L'auteur déroule les conséquences et les conclusions pour chaque facette fiscale qui est discutée. Il est dommage que l'oeuvre ne possède qu'une simple table des matières et qu'un index y manque; c'est justement pour rechercher un terme et pour s'orienter sur une matière définie que les exposés de M. Chrétien auront un profit durable. Et tout spécialement les lecteurs qui s'occupent des traités fiscaux trouveront ici une source qui mérite plein crédit et qui est très complète.

L'auteur se rend compte qu'on se demandera s'il fallait un livre de cette dimension (246 pages compactes) pour arriver à une conclusion qui n'a rien de spectaculaire. Il s'excuse: une règle qui aujourd'hui lie de nombreux Etats peut *demain lier tous les Etats*. Celui qui s'occupe en pratique de la coopération des Etats secoue la tête devant un tel optimisme: c'est un bien long chemin que celui qui mène à un accord international vraiment commun! Mais le droit international en général, le droit fiscal international en particulier, l'intégration même, [4]) sont servis par chaque effort pour harmoniser le droit et les impôts des Etats; il faut commencer par le „commencement"!

— Mon admiration pour le travail de M. Chrétien a jusqu'ici principalement porté sur des généralités. Il me faut entrer dans les détails, pour donner une idée du contenu de l'oeuvre.

Le chapitre I est donc consacré à l'étude de la souveraineté fiscale des Etats, à l'aspect technique, en matière d'impôt, de la souveraineté étatique; il y traite aussi des autres collectivités, spécialement des organismes internationaux, S.D.N. et O.N.U.

L'auteur n'appartient pas à ceux qui prétendent un peu ironiquement que le droit international n'existe pas, pour la seule raison qu'au moment où il devrait être appliqué contre l'intérêt du plus puissant, ce dernier le néglige. Il le prend tout à fait au sérieux, comme il sied à un juriste, et *pour ce qui est de la matière ici discutée*, il n'a pas d'opposition à craindre, puisque la possibilité ou mieux l'impossibilité d'infliger des *sanctions* en droit international entre à peine dans la discussion. D'ailleurs, il ressort du livre même qu'il existe peu de certitudes en ce domaine.

Les arrêts ont beau déclarer (p. 15) que la mer territoriale jouit de

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[4]) Voir mon étude „Europese integratie en belastingen". (L'intégration Européenne et les impôts, 1956).

la souveraineté — cela importe peu (même si l'on distingue entre la pleine mer, la mer libre et la haute mer) si chacun peut déterminer à son gré la distance concrète. Quant à l'espace atmosphérique, je ne suis pas sûr qu'il ne soit pas préférable de dire, par analogie au principe qui vaut pour la mer, que la souveraineté ne va pas plus loin que la distance qui est sous le contrôle de l'Etat survolé, mais on m'opposera que cela n'améliore guère la situation dans la pratique. (Voir d'ailleurs Dr. I. T. Koning, Thèse Leyden 1956: „The legal state of aircraft.)

La conclusion de l'auteur dans le chapitre II, à laquelle je me rallie volontiers, mais qui renferme en même temps un doute, c'est que les prétendues limitations générales à la souveraineté fiscale des Etats, ne sont pas, en tout cas, des règles *certaines* (cf. plus loin).

L'auteur part de l'art. 38 du Statut des Cours en divisant les conventions en conventions générales, coutumes générales et principes généraux. *La convention générale,* est selon lui „tout traité auquel tout Etat (souverain) peut être contractant, puisque les partenaires admettent l'adhésion des Etats non signataires" (aux mêmes conditions que les contractants originaires.) La clausule d'adhésion illimitée (connue déjà au temps de la S.D.N., d'Oslo et d'Ouchy) est actuellement introduite dans mainte convention étatique ou convention de l'O.N.U. et „constitue le caractère spécifique de la Convention générale".

„Du point de vue de son contenu, un traité est une loi (matérielle) dans la mesure où il contient des clauses qui modifient ou remplacent les lois internes des Etats contractants". (p. 36 et 203.) Il est plus clair, me semble-t-il, de dire: il y a des conventions qui obligent les Etats à changer leur législation pour les rendre conforme aux contrats conclus, il y en a d'autres qui obligent nettement et directement les citoyens des deux Etats (self-executing conventions) et cette distinction est importante.

— Savez-vous que le seul traité multilatéral de la S.D.N. et de l'O.N.U. qui est une convention générale entièrement fiscale est l'accord sur le régime fiscal des véhicules automobiles étrangers, du 30 mars 1931? (Voir p. 153.)

— Le traité l'emporte sur la loi, même sur la loi fondamentale, et la loi et les lois fondamentales sont elles-mêmes subordonnées à certaines résolutions (de la conférence générale de l'O.T.I.) [5]) Voir l'art. 405 du Traité de Versailles de 1919 et les décisions — qui ne sont pas des traités — du pacte Nord-Atlantique de 1949 sur le

[5]) L'auteur dit (p. 159): L'art. 3 du Statut de Barcelone contient quelques clauses relatives aux *contributions* douanières. Mais il n'existe pas de *contributions* douanières — aussi l'art. 3 du Statut parle-t-il seulement de *droits* et de *taxes.*

choix d'un généralissime. De plus il y a des traités qui prévalent sur d'autres traités (p. ex. le Gatt, art. XXII § 4). Mais tout cela ne change rien à la conclusion de l'auteur: il ne peut être question de règles communes et certaines qu'après un règlement international; c'est seulement la traité, le contrat, qui fait naître le droit concret.

— Durant plusieurs pages, la distinction intéressante et importante entre impôts extérieurs (droits de douane) et certains impôts intérieurs (contributions indirectes) est examinée. La „taxe à l'importation" dont d'autres (tels les Suisses) disent que c'est une taxe douanière déguisée, est étudiée à plusieurs reprises (voir e.a. p. 46, 60 et 70). Cette question, brûlante dans le milieu du G.A.T.T., et de la communauté Européenne, vaut la peine d'être discutée amplement!

— Une autre observation très juste: „Le *recouvrement* d'un impôt a nécessairement un caractère territorial, l'assiette pas". [6])

— C'est, selon moi, une rédaction peu technique de dire (p. 78—90) que les droits de douane sont nécessairement des mesures „discriminatoires, puisqu'ils frappent uniquement les importations de marchandises de provenance étrangère"; ce n'est pas cela qu'on entend généralement par le terme discriminatoire en langage *douanier*.

— p. 88. L'auteur a pu mentionner encore une convention multilatérale (non S.D.N.) sur les carburants et les lubrifiants signée à Londres le 1er mars 1939, qui était presque mondiale (± 40 adhérents), mais qui -- à cause du déclenchement de la guerre mondiale — n'a pas été ratifiée. L'auteur n'a-t-il pas oublié ici le traité du 7 décembre 1944 de Chicago et l'annexe 9 de ce traité?

— Aux p. 82 et suivants l'auteur donne un résumé des dérogations conventionnelles fiscales existantes, il y revient à la fin de son oeuvre. Il analyse en détail leur caractère, leur portée et la jurisprudence y relative toujours en concluant qu'un droit international fiscal n'existe pas.

Les paragraphes 186—202 figurent parmi les plus importants pour la pratique. Nul ne les lira sans se voir enrichi.

Il n'y a que trois cas dans lequel le résultat est un peu douteux, quoique l'auteur n'hésite presque pas. Ce sont la double imposition et l'évasion fiscale en général, les imunités diplomatiques et l'abus de droit. Commençons par les immunités diplomatiques.

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[6]) Voir aussi Conf. A.F.I. Monaco 1956 Deuxième Res., d. „No tax recommandation should be made between residents and non-residents, the principles of territorial taxes be the true foundation of the tax legislation of each country."

Remarquons que bien que la souveraineté fiscale soit territoriale, le droit international peut faire naître en matière fiscale des relations juridiques entre les Etats et les sujets d'un autre Etat.

Ce serait, dit on, la seule règle certaine du droit international en matière fiscale, et elle serait d'ailleurs limitée aux impôts directs. Mais cette règle n'est pas du tout certaine. Les auteurs (dernièrement van Houtte) les définissent comme une application du principe de l'exterritorialité. Nombre d'immunités existent de temps immémorial. Grotius, suivi par la litérature postérieure, se base sur la fiction d'exterritorialité. Mais ce serait une étude à part de contrôler si toutes les immunités existantes ou non-existantes sont en accord avec ce principe. Encore: cette fiction n'a pas dans tous les pays la même étendue. Ce sont les traités qui fixent les bornes! L'auteur ne les énumère pas et je crois qu'il a raison; il suffit d'attirer l'attention sur le fait que ces immunités changent constamment et qu'elles diffèrent d'un pays à un autre. Cette matière est d'une grande complexité [7]). C'est le mérite de l'auteur qu'on puisse voir clair après l'avoir lu. La Commission pour le Droit international de l'O.N.U. qui est en train d'étudier cette matière pourra tirer profit de son exposé.

Mais je le cite spécialement, pour avoir démontré qu'une partie de ces privilèges sont au fond peu désirables. Et comme ils ont dans les dernières années pris une telle extension, il vaut la peine d'y porter une attention spéciale.

„Ces privilèges (p. 201) ne sont pas accordés dans l'intérêt propre des représentants (des Etats), mais dans le seul intérêt de l'organisation afin de permettre à celle-ci d'atteindre ses buts." L'insistance des conventions est de nature à engendrer le doute, plutôt qu'à entraîner la conviction là-dessus.

Toutes ces mesures semblent davantage être inspirées par la courtoisie internationale [8]) qu'être l'application de coutumes internationales ou de principes généraux.

Ces immunités (p. 234) ne sont d'ailleurs pas nécessaires à l'exercice de leur fonction. L'impôt est une gêne, mais il l'est pour tout contribuable. Il s'agit en réalité d'avantages personnels qui ont été camouflés sous les apparences d'une nécessité. [9])

De plus: ces immunités revêtent un tout autre caractère et une tout autre importance qu'à l'époque où les impôts n'étaient pas si élevés.

En outre, il y a des fonctionnaires de l'O.N.U., de la Commu-

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[7]) Voir par exemple: Bulletin de Documentation fiscale internationale, 4—1956, p. 239.

[8]) Ou „politesse internationale".

[9]) On peut se demander si l'origine des tolérances envers les *agents* diplomatiques ne provient pas du désir de créer une atmosphère bienveillante dans les relations avec l'ambassadeur. Voir aussi plus loin la question de la dignité des Etats.

nauté Européenne du Charbon et de l'Acier et du Conseil de coopération douanière à Bruxelles qui jouissent, de manière encore plus étendue, de privilèges — sans doute exagérés — pour les impôts directs les plus importants. Les impôts directs ont dans plusieurs pays atteint une telle hauteur que ce privilège attribué à des personnes qui reçoivent déjà un salaire beaucoup plus élevé que celui d'un fonctionnaire national est à l'origine de la conception exagérée et ironique que ces fonctionnaires internationaux sont les seuls nouveaux riches! Quant aux droits de douane, les règlements pris à l'initiative des organismes de l'O.N.U., ainsi que les traités dans le sein de l'O.N.U. et avec les U.S.A., contiennent tant de privilèges sur l'importation de marchandises en considération des buts d'un organisme (comme l'Unesco) ou d'un but général (l'OTAN), que le rendement de ces droits en est considérablement diminué; on peut dire que ces mesures sont de nature à miner le système des droits de douanes d'un pays. Leur effet est non seulement de fausser les relations commerciales, mais aussi de faire croire que les frais d'un organisme ou d'un département sont moins élevés qu'ils ne le sont en réalité. C'est surtout important pour les ministères de la guerre (toujours controlés avec méfiance par les Chambres); le budget présente des chiffres inférieurs aux chiffres réels; les montants véritables sont partiellement masqués par les privilèges en matière de droits et de taxes.

— Il y a encore un aspect que M. Chrétien n'examine pas. Il y a des immunités qui s'expliquent par le souci de la dignité et de l'égalité des Etats; l'Etat n'admet pas que son représentant soit assujetti à une puissance étrangère et qu'il soit entravé dans sa liberté d'agir par la possibilité de se devoir justifier envers les organes de l'Etat dans lequel il est accrédité et ceci est justement un cas douteux dont je me demande si nous ne nous trouvons pas devant un „principe général".

La dignité des Etats, leur égalité exigent qu'en matière de privilèges, exemptions et immunités leurs agents respectifs aient un traitement identique.

Pour ce qui est du p. 195, je fais remarquer qu'il existe des règles analogues à celles de 1942 et 1947 et qui — bien entendu — ne reposent pas, pour autant que je le sache, sur une convention. Voir les immunités du Conseil de coopération douanière à Bruxelles.

Les privilèges non-personnels ont, eux-aussi, tendance à s'étendre encore; l'extension de la franchise à l'importation d'échantillons commerciaux destinés à être exposés dans les locaux

[10]) A remarquer que la litérature regarde l'état de droit des agents diplomatiques comme sortant en tout premier lieu de la coutume, celui des *consuls* de traités.

des ambassades, légations et consulats en est un. La question est peut-être de peu d'importance en ce qui concerne les ambassades et légations dont les chefs jouissent, à titre personnel, d'une exemption généralisée puisqu'ils ont de grandes possibilités d'introduire des marchandises dans leurs légations. Il n'en est pas de même pour les consulats gérés par des consuls honoraires, surtout par ceux des Etats de l'Europe orientale qui font le commerce eux-mêmes. Il est bien possible en pratique que les échantillons de commerce importés en franchise temporaire restent finalement dans le pays d'importation temporaire comme marchandise. Il ne faut pas oublier que le contrôle des privilèges diplomatiques est chose très discrète et, déjà pour cette raison, très difficile. On voit que les immunités diplomatiques posent encore maints problèmes.

Le deuxième cas que l'auteur désigne comme „douteux" est l'évasion fiscale, la double imposition en premier lieu (p. 214); mais selon moi il n'est pas nécessaire de discuter longtemps sur ce point-ci. Chacun est d'accord sur le fait qu'il n'existe pas de principe général en ce domaine. Il n'y a que des conventions auxquelles on peut emprunter un droit. Le conseil de l'O.E.C.E. (1950) a considéré que la double imposition est une entrave au commerce international et aux investissements et qu'il faut que les pays participants prennent des mesures pour éliminer cette entrave. *Bühler* declare nettement que le droit international commun ne condamne pas la double imposition. Lieppart, dit l'auteur, page 209 (note 4), écrit que la double imposition semble contraire à l'équité. „Mais en admettant même qu'elle soit contraire à l'equité", dit l'auteur, „celle-ci n'est pas, malheureusement, du droit positif." Je me demande, si l'on peut dire cela d'une manière si „positive"; il y a quantité de juristes qui rangent la coutume sous le droit positif et quantité de juges qui admettent comme moyens d'interprétation l'équité, la bonne foi, les exigences du trafic et autres. Mais en tout cas, nul Etat n'accepte d'être lié autrement que par des conventions en matière d'évasion fiscale sous tous ses aspects. On a fait et l'on fait encore de grands et louables efforts pour élaborer une convention internationale, multilatérale, sur l'assistance en matière fiscale.

Voir Carrol, la prévention de la double imposition et de l'évasion fiscale 1939, le projet contrat modèle de l'O.N.U. (1946) et S.D.N. Genève 1946, Doc. no. c 88, M 88 et mon „Europese integratie en belastingen". Un Comité de l'O.E.C.E. est de nouveau en train (1953) d'étudier la matière. Voir aussi: First annual survey of A.F.I., 1938—1955. Preuves suffisantes que des conventions sont nécessaires!

A la page 71 il est traité du conflit de loi, qui n'existe pas dans

le droit international public en général à l'exception du „renvoi". L'auteur y dit:

„Il n'y a pas de question de conflits de droit (en matière de double imposition et en matière du droit international public en général)."

Comme dans le droit international privé aucune règle juridique ne s'oppose à l'application simultanée de deux législations ou de deux compétences fiscales à un même fait ou à une même contribution (Trotabas, Cah. du droit Intern. II, page 35).

Le deuxième cas „douteux" ne me semble pas très douteux!

Même le troisième cas douteux, l'abus de droit, ne donne pas l'occasion, d'après l'auteur, de penser qu'il y ait une règle certaine de droit international, puisque la Cour n'a jamais défini l'abus de droit et qu'elle ne l'a jamais appliqué. Ces motifs ne sont pas, selon moi, très convaincants.

Nul n'est partisan de l'abus de droit ni du détournement de pouvoir; nul ne l'accepte, ni en droit commun, ni en droit fiscal. Même si c'est en vain que l'on s'est efforcé — sur le plan national et international — de donner une définition nette de cette conception — le droit exige que nous l'acceptions comme principe général ou comme coutume. Il est toujours plus facile de fournir des exemples que de donner une définition. Et il est vrai que cette règle est très difficile à préciser. La conclusion reste cependant la même — ce n'est pas une règle de droit international *fiscal*, mais bien une règle de droit international commun — ce n'est pas une règle *certaine* sans doute, en ce sens qu'elle est difficile à appliquer, mais le fait qu'elle n'a pas été appliquée en droit international ne prouve rien. Elle *est* appliqué en droit *national*, sans qu'il y ait plus de motifs pour l'excercer dans celui-ci que dans le droit *international*. Je ne crois pas qu'Allix, (page 162) est loin d'une définition satisfaisante en définissant ainsi l'abus de droit: „la sorte de détournement de pouvoir par lequel on fait servir intentionnellement à l'aggravation du régime protecteur des mesures, qui, en principe, étaient uniquement destinées à assurer l'application de la loi douanière". Mais il continue: „Faute de pouvoir délimiter exactement où cesse l'usage normal du pouvoir réglementaire et où l'emploi en devient abusif, on ne conçoit guère la possibilité de lutter contre le protectionnisme administratif (en matière de douane) autrement que par des recommandations d'ensemble condamnées à rester dans le vague, ou par des conventions spéciales limitées à un objet précis."

Les observations finales que je veux faire, observations que j'ai déjà annoncées au commencement de cet article, ressortissent au même ordre d'idées.

Jusqu'ici j'ai suivi les grandes lignes de l'exposé fait par l'auteur, sans presque les critiquer; voici quelques objections générales.

Le titre de la Section II au p. 203 est ainsi conçu: *Il n'existe pas de limitations qui obligeraient tous les Etats et qui proviendraient de coutumes générales ou de principes généraux: limitations universelles mais incertaines.*

L'auteur reconnait donc comme seule source de droit international les conventions; il ne voit pas de grande différence entre les deux autres sources et la Cour, dit-il, ne distingue guère entre elles deux.

„Il n'est (p. 207/m) de coutumes certaines que celles qui sont reconnues par la jurisprudence." D'accord [11]), mais ce n'est qu'un *jeu de mots:* la coutume contient par définition un élément d'incertitude!

La coutume, en droit national, pour être reconnue comme telle, doit satisfaire à des conditions précises; il n'y a aucune raison de ne pas la reconnaitre en droit international dans des conditions analogues. Quant aux *principes généraux,* il faut faire des distinctions. J'ose traduire les termes „juris praecepta" d'Ulpien et Justinien (rechtsbeginselen" litéralement: — commencements du droit — en neerlandais) par les termes „principes de droit généraux". On pourrait dire qu'ils sont au moins de droit potentiel. Ne peuvent-ils devenir aisément droit *tout court* plus tard? Il y a de ces principes qui sont très vagues comme ceux de Justinien (honeste vivere, alterem non caedere suum cuique tribuere); ils sont trop vagues pour avoir quelque signification réelle, concrète, pour le droit, soit national, soit international. Il y en a d'autres qui sont plus concrets, comme la bonne foi, la „bona fides" (voir l'art. 1135 C.C.) et qui sont de droit positif. Il y a de ces principes qui ne sont pas mentionnés dans une loi (ou traité): le juge n'est pas lié. Il y en a d'autres qui sont expressément fixés dans la loi (p.e. bona fides en matière de contrats): le juge est lié.

En outre celui qui veut respecter le droit, qui ne cherche pas à s'y soustraire, ne négligera pas plus le principe de l'abus du droit que tout autre.

Le droit international, comme le droit en général, repose sur l'obligation (parfois dérivée de la loi des *moeurs*) pour les Etats et pour les individus de rechercher le bien-être général. En conclusion, c'est donc seulement par ce que l'auteur a interpolé les mots „règles *certaines*" que l'on peut être absolument d'accord avec lui sur le fond. Mais son jeu juridique m'a plu et son livre instruit sur un sujet spécial comme peu d'autres le font.

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11) Mais qu'est ce que l'auteur dit p.e. des coutumes (formelles) selon lesquelles les conventions sont exécutées.

Organisation and Management: Theory and Practice, by Catheryn Seckler-Hudson. American University Press, Washington D.C., 1955, pp. 324.

Your reviewer went through three distinct phases in reading this book. First, as he looked at the contents, sampled a few pages and footnotes he thought how boring and ordinary it is with its constant references to Follett, Urwick and Gulick, its complicated diagrams and its complete concentration on the practice of the U.S. Federal Government. So he started prejudiced against it. Then as he got deeper into the book there was a short period when he thought he had found the text book on public administration for which he had been waiting. The analysis was clear, the different aspects were set out in a way helpful to the student and even most of the diagrams (he has an inherent suspicion of diagrams), were found on inspection to add greatly to the exposition. Finally, as he read through to the end he came to the conclusion that though it was a useful textbook, and indeed the author did not claim it to be any more, it was uneven and was not without serious blemishes.

Any blemishes do not arise out of the almost exclusive concern with organisation and management as seen in the U.S. Federal Government. Indeed Professor Seckler-Hudson has deliberately avoided including descriptive detail in case it should rapidly become obsolete. And she seldom if ever suggests that the only answer or even the right answer is to be found in current Federal practice. Moreover, one of the great merits of the book is that it provides a good many 'check-lists' and criteria which would be valid in or readily adaptable to the practice in any country. Mind you, an Englishman or a German or a Swede reviewing a textbook on public administration in an international journal might be tempted to suggest that occasionally a reference to the practice in his country might not be altogether out of place.

This brings us to a major problem confronting those who wish to develop the study of organisation and management. Is there a theory valid for all countries or is there an American theory, an English theory, a Dutch theory and so on? In so far as administration is carried out by human beings and must therefore be affected by their attitudes and ideas any differences between countries in these would, have to be taken into account — what Professor Seckler-Hudson classifies as human dynamics and the dynamics of politics and public opinion and of changing social situations. But these are adjustments of a general theory. The major processes of organisation and management which, according to the author include policy formation, planning, budgeting and staffing — have to be

undertaken in any country. Again the list of criteria Professor Seckler-Hudson gives to be used in the process of delegating authority are also international: such as: Is the responsibility assigned or delegated commensurate with the authority granted? and: Is the delegation of authority so made as to preserve unity of command or unity of purpose? A large part of the book deals with general matters of this kind and therefore to that extent is useful to teachers, students and practioners in any country. There is a particularly useful general Chapter XII setting out the points to be borne in mind in conducting an O & M Survey (similar in character to the excellent booklet put out by the British Treasury).

In the chapter on the budgetary process and to a rather lesser extent in the chapter on staffing this general approach seems to desert the author. Some two thirds of the short and rather disappointing chapter on the budget is about the history of and the present general arrangements for the Federal Budget and most of the rest is closely linked with a knowledge of those arrangements. At this point the book ceases to be a general textbook on organisation and management and becomes just another exposition of American government. Is this because the budgetary process can be presented only in national terms? Probably not — indeed there is a considerable international literature on this most central of administrative processes.

Perhaps the answer after all is that though one can get some way with general criteria and analysis applicable in any country or in any form of public administration — central or local — there are occasions when, if the exposition is to mean anything it must be tied to actual examples. Perhaps after all some of the other chapters might have been more telling if actual cases could have been quoted to show how this or that problem was dealt with. But in that case would the textbook have such a general appeal?

There were one or two other points that worried me slightly in the book, particularly the tendency to look at everything from the top level and the tendency to treat each process as separate and not to show its continuous relation with the others. Nevertheless Professor Seckler-Hudson has undoubtedly given us a very useful addition to the limited number of general textbooks on public management.

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FISCAL POLICY IN ARGENTINA

by FEDERICO JULIO HERSCHEL
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*Introduction: *)*

We shall try to explain the evolution of Fiscal Policy in the Argentine Republic during this century, having in mind the attainment of three main aims: [1])

1) the effect of Fiscal Policy on the general level of Economic Activity,
2) the effect on Income Distribution,
3) the effect on Resource Allocation.

To accomplish this purpose, we shall divide this paper in the following parts:

1) Before 1930,
2) 1930—1943,
3) 1943—1955,
4) after 1955.

Our division is marked by important political events. It is significant that these changes keep a close relationship with fundamental changes in the Argentine fiscal structure.

The beginning of the second period is characterized by the introduction of taxes, completely new to the Argentine tax system, by the revolutionary government.

The third period begins with another „coup d'état" followed by the creation of new levies and changes in the whole structure of expenses and revenues of the Federal Government.

The last period, which is still developing, shows again important modifications in the tax system.

In order to get a right idea of the legal environment of the Argentine fiscal structure, it must be kept in mind that in a lesser degree, but not very different from the American States, the so-called Argentine Provinces can levy taxes by their own right.

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*) In preparing this paper we had to face the same difficulty with respect to statistics as Professor Patterson stated in his article in this review (Vol. XI - No. 1/1956. - We tried to stress more interpretation of statistics and some of the data used are rough estimates; but nevertheless on the whole we think they are sufficiently representative of the general trend.

[1]) We shall also study when necessary the efficiency of tax administration.

According to the Constitution certain taxes may be imposed only by the Federal Government (mainly custom duties) but according to the letter of the Constitution direct taxes belong to the sphere of the Federal Government only for a limited time. The Federal Capital and formerly also the so-called National Territories depend directly from the Federal Government, forming the National Jurisdiction.

Those taxes (inheritance tax, land tax, stamp duties, etc.) which are collected in the provinces by provincial governments are levied in the National Jurisdiction by the Federal Government and included in its budget.

In this paper we have not analysed the incidence of multiple exchange rates which in some years provided the government with additional revenues. An exhaustive analysis would consider them as direct or indirect taxes when charging exports or imports, or as subsidies if low rates were adopted for imports.

We recognize the importance of multiple exchange rates in development policies but in our opinion the introduction of this subject would exceed the scope of fiscal policy as its study could not be divorced from Balance of Payments problems.

FIRST PERIOD: 1900—1930

During the 19th Century we cannot speak of an organized budget, because having begun its Constitutional organization in 1853, after a period of internal war and anarchy, the last decades of that century were still full of unstable financial conditions, but, nevertheless, the country pursued its way to economic progress. Therefore with the beginning of the 20th century, it would have been possible to have established a budget, as an organic plan of expenses and resources, which the Government was willing to fulfill.

We shall see why this aim was not accomplished. The budgetary deficit was a chronic state in Argentina. The deficit was not a result of a deliberate goal of the Executive, it was mainly the consequence of a failure of calculation and a deficient administrative organization. In that connection we reproduce a sentence made by a former Minister of Finance: "The President of the Republic, as it is natural, delegates in his ministers the preparation of the Expenditure Budget, and these delegate this task to the heads of the administrative offices, who merely reproduce the existing state of expenditures without other modification than the creation of new services and expenditures, generally useless, and the increase of their own salaries and of those of their preferred employees. The

activity of the President and the Ministers, with the exception of the Minister of Finance is limited almost always to the authorization of new expenses to content a Governor or a political influential."

From this excerpt it is obvious that there was no real budget, because outside the ordinary budget we find expenditures authorized by special laws and ministerial agreements which amount to another budget, as can be seen in Table No. 1).

Table 1.

PUBLIC EXPENDITURES
(1900—1927)

Million of pesos

Years	Budget	Special Laws	Ministerial Agreements
1900	137,9	18,8	1,5
1901	147,7	13,7	1,0
1902	171,3	30,2	0,8
1903	166,1	9,4	2,9
1904	160,0	30,6	4,4
1905	179,7	139,5	7,1
1906	217,0	32,0	12,3
1907	216,7	29,3	7,1
1908	221,8	20,5	10,0
1909	243,7	134,7	13,7
1910	264,6	134,7	11,8
1911	322,0	87,2	7,2
1912	378,9	21,1	4,1
1913	380,2	27,1	2,1
1914	383,7	21,0	8,8
1915	352,6	35,3	11,9
1916	340,7	11,9	22,0
1917	352,2	7,8	29,4
1918	370,3	13,3	37,4
1919	368,6	19,5	39,5
1920	419,6	30,9	37,1
1921	483,6	11,3	65,2
1922	525,6	10,2	78,6
1923	586,8	44,2	1,1
1924	646,2	14,6	10,3
1925	634,5	45,8	33,0
1926	673,8	34,1	37,7
1927	769,4	259,7	19,6

Source: Guaresti Juan José, Economía y Finanzas de la Nación Argentina, p. 192.

If we study this permanent deficitary situation introducing into our analysis the cyclical fluctuations, although there are certain difficulties owing to the lack of exact statistics and the irregularity of the deficit movement, we can say that in general — even

unconsciously — there was some kind of anticyclical policy during the depressions.

In the deflationary period the Government spendings were increased, mainly in personnel.

This contributed to the fact that in Argentina there was comparatively little unemployment. [2]) This relatively low level of unem-

Table 2

BUDGETARY DEFICITS AND VALUE OF EXPORTS OF THE ARGENTINE FEDERAL GOVERNMENT
(1900—1930)

Million of pesos

Years	Value of export	Deficit
1900	350,9	9,7
1901	380,7	11,5
1902	407,5	47,8
1903	501,4	6,1
1904	599,7	+ 4,0
1905	732,7	115,1
1906	663,5	29,7
1907	672,3	7,1
1908	830,8	+ 10,5
1909	902,1	107,4
1910	883,3	103,1
1911	777,0	78,5
1912	1.138,8	41,1
1913	1.178,6	33,0
1914	915,0	137,8
1915	1.321,6	147,1
1916	1.300,7	119,8
1917	1.248,9	135,5
1918	1.819,4	91,4
1919	2.340,4	17,3
1920	2.369,9	+ 30,9
1921	1.523,4	94,9
1922	1.534,5	151,8
1923	1.751,1	84,7
1924	2.295,9	102,8
1925	1.970,1	51,8
1926	1.798,3	106,4
1927	2.291,1	368,2
1928	2.393,7	158,8
1929	2.164,9	251,0
1930	1.394,0	366,0

+ Surplus.
Source: J. J. Guaresti (hijo), Economia y Finanzas de la Nación Argentina.

[2]) Although Alejandro G. Bunge "La desocupación en la Argentina" gives for the years of depression 17 % of unemployed, he includes what has to be considered

ployed was influenced by the fact that the number of employees in Public Administration constantly increased. (e.g. in 1895 1,5 % of the labour force was employed in the Government and in 1914 this percentage in creased to 3,3 %). [3]) and [4])

On the countrary the booms were accentuated by this policy. As can be seen in Table 2), in some years the amount of the deficit was important in relation to the value of exports which we use as indicating the General Economic Activity.

As can be seen from the Table 2, the deficit of the years 1902, 1913/1914, 1918/1919 and 1929/1930 was considerable. These were precisely years of depression for Argentina.

With regard to the Welfare aspect of the Argentine Budget, during the first decade of this century approximately 10 % of the total expenditures of the Federal Government was spent for educative and social assistance. Moreover not the whole of the expenditure for education was included in the Budget, because we can find in this field a special feature of fiscal administration. It consisted of the collection and use of the Death Duties by the National Council of Education. (Consejo Nacional de Educación).

Since 1884 Primary and Secondary schools were established almost exclusively by the Government. Attendance to primary schools was completely free of any charges and the cost of higher education was comparatively small.

On the other hand social assistance, the other Welfare item in our classification, consisted almost exclusively of pensions to government employees and military personnel. Outside the Federal Budget, the States and local governments made Welfare expenditures: the States mainly for primary education and the municipal governments for public health.

During the 30 years which comprehend this period we can observe a steady growth of Welfare items. As can be seen in Table 3 the participation of that item in the Federal Budget doubles approximately, from the beginning of the 20th century to the end of the second decade and afterwards maintains the same proportion. With regard to administration — including police and postal service — its proportion amounts to almost a third part of the Federal Budget. Although welfare expenditures increased, the constant proportion of administrative expenditures confirms what is so often claimed in

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a special kind of frictional unemployment, (people who work only during the harvest).

[3]) Gino Germani "Estructura Social de la Argentina", page 134.

[4]) „With few exceptions these Public employees are recruited from the files of unemployment and hunger" (Cf. Francisco J. Trianes „Desocupación, Burocracia, Prodigalidad".).

Table 3

CLASSIFICATION OF THE EXPENDITURES O

Years	National Defence			Welfare			Development Public Works	Debt Service	Re
	Army	Navy	Total	Pensions	Education	Total			
1900	18,7	11,7	30,4	5,5	9,5	15,0	12,1	55,4	
1901	16,2	11,1	27,3	5,9	8,8	14,7	10,8	64,2	
1902	23,3	31,1	54,4	5,5	9,2	14,7	4,0	76,1	
1903	16,1	9,2	25,3	5,7	8,9	14,6	13,4	81,5	
1904	20,8	12,5	33,3	6,3	11,8	18,1	28,9	64,8	
1905	21,2	14,0	35,2	4,7	14,0	18,7	25,8	61,5	
1906	16,6	11,7	28,3	7,7	20,8	28,5	43,4	61,5	
1907	19,8	14,5	34,3	8,5	27,7	37,2	32,0	63,7	
1908	21,4	14,6	36,0	9,4	25,7	35,1	27,0	66,1	
1909	40,4	17,3	57,7	10,3	26,1	36,4	91,2	66,9	
1910	37,3	49,5	86,8	11,1	30,2	41,3	91,6	66,3	
1911	74,6	20,3	94,9	12,3	36,8	49,1	92,2	67,3	
1912	46,2	27,4	73,6	22,2	39,7	61,9	70,9	71,2	
1913	43,8	24,6	68,4	26,2	41,8	68,0	66,2	81,1	
1914	35,9	37,9	73,8	27,2	51,1	78,3	61,9	82,2	
1915	31,6	23,4	55,0	25,4	51,0	76,4	38,0	83,9	
1916	29,3	23,4	52,7	26,0	47,3	73,3	29,8	85,3	
1917	38,4	24,4	62,8	27,9	52,6	80,5	14,9	85,6	
1918	31,9	32,0	63,9	26,9	57,0	83,9	13,4	118,8	
1919	37,3	29,1	66,4	27,8	57,2	85,0	18,8	117,1	
1920	43,2	35,7	78,9	30,3	67,2	97,5	27,3	113,5	
1921	51,2	42,4	93,6	31,2	76,9	108,1	49,5	118,1	
1922	51,5	40,6	92,1	31,5	82,3	113,8	50,2	119,3	
1923	57,2	44,1	101,3	37,8	79,1	116,9	66,7	117,8	
1924	58,8	45,7	104,5	41,2	76,6	117,8	66,5	129,6	
1925	65,7	54,1	119,8	40,7	76,8	117,5	72,1	128,8	
1926	75,9	56,2	132,1	40,8	80,7	121,5	71,4	149,9	
1927	111,9	101,6	213,7	48,8	84,6	133,4	128,0	183,3	
1928	97,9	60,5	158,4	54,2	90,0	144,2	134,7	193,5	

Based on: Ministerio de Hacienda de la Nación, Memorias Anuales.

the literature about Argentine Civil Service, namely the evil of Bureaucracy as a retarding factor in Argentine economic development.

The evolution of public works does not follow any definite pattern, and does not coincide with our statement of a certain degree of anti-cyclical policy which is therefore limited to the effect of the payments to public servants.

The Budget for military purposes was relatively high, but the political tension with the neighbour Republic of Chile justifies to some extent the high level of this kind of expenditures during the first ten years.

As a consequence of the prevailing liberal conception of the

TINE FEDERAL GOVERNMENT (1900—1928)

Administration								Total
Congress	Ministry of Interior	Foreign Affairs	Finance	Justice	Agriculture	Public Works	Total	
2,5	15,6	2,6	7,5	3,5	2,5	8,3	42,5	159,1
2,5	14,4	2,9	7,9	3,3	2,1	6,8	39,9	160,9
2,5	14,8	3,0	7,7	3,9	3,0	10,5	45,4	198,7
2,6	15,5	3,1	7,8	4,3	3,4	2,7	39,4	178,2
2,8	18,3	2,7	8,9	4,5	4,6	3,2	45,0	195,1
2,8	23,3	2,9	11,0	5,6	6,4	6,1	58,1	288,6
3,0	23,2	2,1	11,1	6,9	10,2	5,4	61,9	233,5
4,1	24,6	3,5	12,6	6,7	15,8	5,2	72,5	253,0
4,4	25,9	4,6	12,8	6,6	13,4	4,4	72,1	252,2
4,2	31,0	5,5	16,5	8,1	15,7	5,4	86,4	347,4
4,4	38,2	9,0	17,6	9,1	23,5	5,9	107,7	404,6
4,7	40,7	6,6	17,5	11,8	18,9	11,2	111,4	414,9
5,1	42,7	7,4	22,9	13,4	15,4	13,1	120,0	397,6
4,8	48,2	5,7	21,4	14,3	16,7	9,2	120,3	404,0
4,9	51,5	4,9	24,5	13,3	15,3	9,0	123,4	429,6
4,5	53,3	4,6	37,0	12,9	17,3	17,1	146,7	394,5
4,6	49,9	4,6	41,7	12,7	12,9	8,4	134,8	375,9
4,7	47,3	4,3	34,2	11,0	25,7	8,5	135,7	389,5
4,6	48,6	4,4	31,3	12,5	13,5	13,2	128,1	421,1
4,5	58,8	4,3	28,7	12,4	20,3	10,3	139,3	426,6
5,2	67,7	5,9	37,0	14,4	18,8	21,1	170,1	487,3
5,6	75,4	9,3	27,3	14,9	17,5	21,8	171,8	541,1
5,7	78,2	6,1	20,8	12,1	17,6	22,9	163,4	493,3
5,7	74,8	6,0	22,9	16,3	14,9	15,0	155,6	558,3
5,8	74,6	8,0	22,4	17,3	19,5	23,5	171,1	589,5
5,6	76,5	8,7	22,7	17,7	29,1	23,6	183,9	630,5
5,7	76,9	9,0	22,8	17,5	21,1	28,4	181,4	661,4
6,2	117,5	11,7	27,9	21,2	27,0	23,8	235,3	1026,8
6,1	113,7	12,5	36,5	20,5	51,4	22,2	262,9	895,2

Economy, the State participation was limited and consisted mainly in expenditures in those fields where private activity was reluctant to invest owing to risk and low profit at the beginning. We can mention the construction of the railroads which had the purpose of developing the underpopulated and distant regions of the country. [5]) Another field of investment was the beginning and development of oil exploitation and industry by a state enterprise (Yacimientos Petroliferos Fiscales). The rest of public work comprises the more familiar types of Government activity in those years: mainly construction of ports, bridges and roads.

[5]) A. F. S. Silenzi di Stagni „La Nacionalización de los ferrocarriles" in Revista de la Facultad de Ciencias Económicas, March 1948, page 7.

During this period the Argentine tax system was deficient in many ways. It dit not accomplish any of the three goals stated. From the point of view of its social effect, the composition of taxes was regressive. The basis of the system were consumption taxes, namely Excise and Import duties. This was aggravated by the existence of similar internal consumption taxes in the provinces, which frequently affected the same products already taxed by the Federal Government. The goods subject to Excise taxation by the Federal Government were tobacco, alcoholic beverages and alcohol (i.e. for in-

Table 4

TAXES OF THE FEDERAL AND PROVINCIAL GOVERNMENTS

(Million of Pesos)

	1910	1915	1920	1925	19
A. Indirect taxes	264,4	197,8	332,2	578,8	67
I. Taxes of the Federal Government	238,1	170,4	280,2	450,5	50
a) Excise taxes	49,3	60,5	88,–	100,2	11
Alcohol	16,6	10,5	15,2	17,2	2
Tobacco	23,2	32,9	45,1	56,4	6
Matches	3,4	4,2	4,1	4,3	
Beer	4,–	3,5	5,8	5,–	
Insurance	0,8	0,9	1,6	1,–	
Playing cards	0,2	0,2	0,4	0,6	
Perfumes	0,9	0,7	3,6	0,4	
Wines	—	0,6	1,7	2,2	
Alcoholic Beverages	0,2	7,–	10,5	13,1	1
Mineral Waters	—	—	—	—	
Jewels	—	—	—	—	
b) Civil, Commercial and Judicial actions	14,4	12,4	30,4	43,4	4
c.) Import duties	174,4	97,5	161,8	306,9	34
II. Provincial taxes	26,3	27,4	52,–	128,–	16
Excise taxes on wine, alcohol and sugar	6,1	9,3	20,8	55,8	7
Other excise taxes	1,2	0,6	5,6	34,7	4
Farm production	4,9	5,2	5,–	7,8	
Civil, Commercial and Judicial actions	14,1	12,3	20,6	30,–	3
B. Direct taxes	49,6	84,1	204,3	161,9	18
I. Taxes of the Federal Government	6,8	13,2	121,6	81,6	6
Export taxes	4,1	6,2	96,8	47,5	1
Land taxes	4,1	6,2	7,3	13,1	1
Taxes on trade, industry, Professions	1,1	3,9	8,2	10,4	1
Death duties	1,6	3,1	9,3	10,6	1
II. Provincial taxes	42,8	70,9	82,7	80,3	12
Land taxes	29,2	48,2	53,8	62,2	9
Taxes on trade industry, professions	12,–	19,6	20,7	6,2	
Death duties	1,6	3,1	8,2	11,9	2
Total (A + B)	314,–	281,9	536,5	740,7	85

Source: Revista Económica del Banco de la Nación Argentina (1930/31).

dustrial or domestic usage), sugar, beer and matches. (See Table 4) [6])

We therefore do not agree with Robert A. Rennie, [7]) who affirmed that consumption taxes can be an appropriate substitute for Income taxes in developing countries, at least with regard to the Argentine case. Our conclusion does not change if we consider import duties. Although some of these duties were levied on luxuries, the main impact was on consumer goods or raw materials which in the last instance fell on the lower income group.

The predominance of custom duties was a special feature in the Latinamerican countries' budgets. It was a legacy of the Spanish Economic System which tried to subject the local production to heavy duties in order to promote Spanish industries. [8])

This not very fortunate situation of the tax system was criticised already at the beginning of the century by Dr. Terry. Later on, Professor Gaston Jèze, [9]) in a remarkable lecture given at the Buenos Aires University, pointed out the regressive character of the Revenue system.

Apart from being an archaic system, the dependency of almost the entire budget from that single source subject to fluctuations under no internal control created a high vulnerability of the Finance system in case of war or other contractions of the world economy.[10])

The limited field of direct imposition was represented mainly by land taxes, death duties and license taxes on trade, industries and professions. With respect to export duties, whose origin can be traced to the very beginning of the Argentine as a free nation in 1810, they were suppressed and reintroduced several times. Finally, this tax was reinstated in 1917. Although it was in general a crude system, there were some sophisticated devices.

The tax was ad-valorem and the rate (12 %) was calculated on the difference between the real export price and a fixed price which represented the 1914 level.

The high revenue of this item in the first years of collection is to be explained by the favorable demand conditions for Argentine exports. But a few years later, as a consequence of a changed market

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[6]) With reference to the Provences we can list the following items subject to consumption tax: *Buenos Aires:* beer, *Tucumán:* tabacco, cigarettes, wines, artificial beverages, sugar and alcohol, *Mendoza* and *San Juan:* wines and several kinds of brandies, *Córdoba:* wine, alcoholic beverages, tobacco and cigarettes.

[7]) Argentine Fiscal Policy, Interamerican Economic Affairs, Vol. I, No. 1, June 1947.

[8]) Salvador Oria „Finanzas", Vol. II, page 539.

[9]) „Las Finanzas Públicas de la República Argentina", Buenos Aires 1923.

[10]) Prof. Terry forsaw this danger which later on proved to be true.

situation, the yield of that tax decreased. The Argentine experience confirms therefore the general accepted principle that a country cannot rely on export duties since the revenue depends too much on fluctuations of the world market. [11])

With the exception of the few years of the export boom, when export duties were the most important direct taxes, the main revenue among the direct taxes came from the Land Tax. According to the Federal Constitution, this tax must be levied by the Provinces. Nevertheless, at the beginning of this period, owing to the growing financial needs, due to the tension with Chile, a project to create a national land tax was elaborated. Besides the constitutional problem, another difficulty would have been the distribution of the revenue among the Provinces and the Federal Government. For these reasons the project dit not materialise.

Although there were differences in the tax laws of each state, certain general features can be pointed out.

First of all, the basis of the tax was the value of the land. In that way the Argentine did not follow the Spanish tradition according to which land was not taxed directly but by external signs.

Until 1918 all the provinces and the Federal Government (in the National Jurisdiction) taxed land on a proportional basis. In 1918 Entre Rios was the first province to introduce a progressive rate on the value of land. The progression was fixed according to the extension of the land. [12])

In 1926 the Province of Santa Fé introduced a progressive scale in accordance with the value of the land.

In the National Jurisdiction projects presented to Congress in order to introduce a progressive system based on the value of the property were rejected. [13])

Considering the importance of the land wealth in relation to the total wealth of the country, the insufficiency of the land tax rates is evident. As we have seen, only few provinces had progressive rates and even these were very small.

As in Argentina there was a strong concentration of land in the hands of few big landowners and Corporations, not sufficient attention has been paid to the tax capacity principle.

With regard to death duties until 1905 there was no progressive

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11) Taxes and Fiscal Policy in under-developed countries, page 39, - United Nations.

12) At the lowest scale the rate of taxation was ¼ $^0/_{00}$ for extensions between 100—200 Hectares, reaching a maximum of 4 $^0/_{00}$ for extensions over 20.000 Hectares, but in no case could the tax be higher than 1 % of the land value. Salvador Oria, op cit. page 257.

13) E. Gonzalez Litardo, Finanzas, Vol. I, page 258.

inheritance tax. In the National Jurisdiction the creation of an inheritance tax was caused by a special circumstance. When the general elementary school system was introduced, the need for funds to sustain the system obliged the statesmen to search for a source of revenue. So, the inheritance tax was born. Due to this origin this tax was earmarked to the National Council of Education and this Institution was also charged with its collection. The tax rates before 1905 were 5 % for all relatives (being exempt all relatives in the direct line and brothers and sisters), and 10 % for any other heir. In 1905 tax progressive rates were introduced in the National Inheritance Tax. In all provinces the tax is levied in the form of an inheritance tax on the various shares received by the heirs.

Commerce and Industry were taxed only with a license tax whose origin goes back to the time of the colony. In the National Jurisdiction, in 1899 all the different taxes were put together in one law. Similar to the old french system (Patente) it was levied on a lump-sum basis, although some were graduated according to the branch and importance of the business. The system in the provinces was similar. Although in these years the agricultural sector still dominated, industry and commerce were important enough to justify a much higher contribution to the revenue of the Government.

SECOND PERIOD: 1930—1943

With the beginning of the World Crisis of the 30's the Federal Government had no weapons to fight the critical situation. In the fiscal field the predominant idea in Argentina was the convenience of the budget equilibrium, as can be appreciated reading the Budget Messages of the year 1933 and following. The Executive worried constantly on the necessity to reduce expenditures in order to accomplish the desired end. [14])

During the first year of this period there was a considerable deficit due to an increase in expenditures which could not be cut immediately. Moreover there was a corresponding decrease in federal revenues, mainly in consumption taxes and custom duties. But from the next year on, drastic measures were taken to reduce expenditures. The total absence of any countercyclical policy is confirmed by the later evolution of the budget until 1935. When in the next years — during the upswing of the cycle — a superavit was reached, this was not due to a deliberate policy but to a natural increase in fiscal revenues.

14) Cf. Diario de Sesiones - Cámara de Diputados, July 19th, 1933.

Even in the last years of this period the anticyclical policy was limited to monetary measures which could be accomplished after the Central Bank was founded and the Banking System organized (1935). There was a complete divorce of the policies followed by the Central Bank and the Fiscal Administration. If in some year (as for instance in 1938) there was a deficit in a critical year or a superavit in a boom (1936) this was only due to the fact that taxes

Table 5

BUDGETARY DEFICIT AND SURPLUS
OF THE ARGENTINE FEDERAL GOVERNMENT
(1931—1943)

(Million of pesos)

Years	Deficit or Surplus
1931	— 131,4
1932	— 41,4
1933	— 23,6
1934	— 9,5
1935	+ 24,9
1936	+ 0,6
1937	+ 10,8
1938	— 194,8
1939	— 60,5
1940	— 170,1
1941	— 261,5
1942	— 249,1
1943	— 335,7

+ Surplus — Deficit

Source: Cámara de Diputados de la Nación - Diario de Sessiones 15 y 16 de setiembre de 1949 - p. 3591.

(mainly custom duties) followed the evolution of National Income, but expenses could not be diminished — with exception of the revolutionary Government (until 1932) (See Table 5). — Certainly such a policy of "sound finances" could be understood at the beginning of the 30's but later on it is difficult to understand the lack of application of the new theories, in full use in other countries.

With regard to the structure of the expenditure side of the budget, there was no fundamental change over the foregoing period; a certain increase in pensions can be seen, but already in these years, we can state that a certain amount of social benefits was not charged to the Government but put on the shoulders of the exployers. (See Table 6). [15])

[15]) For instance, instead of unemployment assurance the Argentine Law obliges the employer to pay compensations to dismissed employes. (Law 11.729).

Although there was a growing trend in the expenses for education, the proportion of this item did not change substantially in the budgets of these years. This can be explained partially by the fact that there was no fundamental shifts in the educational system. This feature has special interest in the study of the development of the Argentine Economy. Expenses for science and technical research were not sufficient for a rapid technological change. Although the access to higher education was easier than in other Latinamerican countries, it was not sufficient to provide enough graduates in certain strategical fields.

The main contribution during the period to the creation of the social capital of the country was the construction of the main roads [16]) and the purchase of more than a dozen ships which constituted the foundation of the Argentine Merchant Navy. [17]) Dominated by the idea of the equilibrium of the budget with the decline of resources the Revolutionary Government, which took power on 6th September 1930, had to face the big deficit of the fiscal year 1930.

In order to overcome the critical financial situation which obliged the Government to ask for credit facilities from private Banks, [18]) the Minister of Finance, Dr. Uriburu, introduced in October 1931, a consumption tax as the first step of a number of tax measures. The so-called Impuesto a las Transacciones was derived in certain measure from the old Spanish alcabala tax, although the rate was lower (3 °/₀₀) in the new tax and was applied to each sale through which a commodity passes.

When the tax after the beginning of a new constitutional government was presented to Congress, a member of its financial Committee expressed clearly that only revenue considerations had been given attention when the tax was introduced. Also the inconveniences of the new tax were stated and the Committee expressed the hope that the tax be repealed as soon as the equilibrium of the budget were reached. [19])

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16) With the same structure as railroads, i.e. to the exports centers.

17) President Castillo bought 16 ships from Italy (88.300 tons), three from France and four from Denmark.

18) It is worthwhile to quote Minister Hueyo's words when owing to the critical financial situation he had to summon the managers of the main banks of Buenos Aires and tell them "the government needs the sum in view of the miserable situation of public employees and a further delay in the payments of their salaries would be impossible and the credit of the country demands the fulfilments of engagements". A. Hueyo, "La Argentina en la Depresión Mundial", page 300.

19) Cf. Alejandro Ruzo "Curso de Finanzas y de Legislación Financiera Argentina. To. II, Teoría Moderna del Impuesto, pag 269/71.

Table 6

CLASSIFICATION OF THE
FEDERAL G

Years	National Defence			Welfare			Debt Service	P
	Army	Navy	Total	Education	Pensions	Total	Total	
1930	103,1	58,1	161,2	128,3	67,2	195,5	232,0	
1931	89,5	57,9	147,4	104,3	66,1	170,4	236,8	
1932	77,1	56,2	133,3	94,8	60,8	155,6	288,0	
1933	80,7	53,4	134,1	89,9	58,9	148,8	379,8	
1934	86,0	57,1	143,1	128,0	65,9	193,9	301,9	
1935	96,5	65,5	162,0	155,0	84,9	239,9	444,1	
1936	99,8	96,1	195,9	170,7	93,9	264,6	258,3	
1937	127,7	124,9	252,6	193,2	99,0	292,2	998,3	
1938	147,5	114,1	261,6	208,9	110,5	319,4	247,1	
1939	143,7	88,1	231,8	225,0	115,5	340,5	223,3	
1940	141,5	87,0	228,5	230,6	118,3	348,9	261,0	
1941	159,8	90,9	250,7	236,9	122,7	359,6	476,3	
1942	227,0	129,2	356,2	239,6	134,8	374,4	308,7	
1943	211,1	118,6	329,7	253,6	152,9	406,5	374,4	

Based on Ministerio de Hacienda de la Nación - Memorias Anuales.

The main objection raised was the turnover form of the tax. The tax had only few exemptions: mainly the sales of smaller businesses, sales by the bakeries, butchers and milkmen, and of newspapers and the sale of grains, meat and some other not manufactured food products. When the law was presented to Congress, some modifications were introduced in the Original tax. The coverage of the tax was amplified and all kinds of transactions became subject to taxation, not only sales as before, but also the lease of goods and services. The new law (Law 11.587 from the 17th of June 1932) imposed a higher rate on the sale of luxuries (furs, jewels, cars, etc.) but a few months later, this clause of the law was suppressed and the uniform rate of 3 $^{0}/_{00}$ was reintroduced. Finally in 1934 the tax got its final structure, which has been maintained fundamentally up to-day. Its main feature was the following: it became a real sales tax as the other operations previously subject to the Impuesto a las Transactions were no longer imposed by the new tax (Impuesto a las Ventas). [20]) — Another characteristic of the tax was — and still is — that it is a single stage tax; all domestic sales are subject to

[20]) Government Message to the Congress - December 1934.

S OF THE ARGENTINE
1930—1943)

Administration								Total
Interior	Foreign Affairs	Finance	Justice	Agri-culture	Public Works	Misc.	Total	
134,7	9,0	34,6	21,1	27,6	35,2	4,3	271,5	1043,0
123,4	8,5	27,6	21,3	23,1	38,2	—	244,4	876,1
115,6	7,6	29,2	28,6	20,9	48,3	—	255,6	874,9
117,9	8,5	37,3	23,3	35,3	29,9	—	257,3	1006,9
122,2	9,6	83,0	23,7	24,4	36,3	—	304,5	1053,5
115,5	8,4	92,0	25,7	28,0	37,0	—	312,6	1284.1
130,1	9,5	68,5	27,0	33,7	31,7	—	306,4	1157,5
140,5	12,0	40,7	29,0	42,1	37,6	—	308,0	2032,6
140,0	11,9	51,5	31,1	54,2	54,7	—	349,9	1364,7
160,6	11,6	62,2	32,0	46,2	49,6	—	368,9	1485.1
135,3	15,9	57,9	37,3	46,2	36,4	—	335,8	1390,4
138,5	11,1	47,1	37,3	54,1	35,7	—	330,6	1596,5
142,3	11,4	56,0	45,2	78,5	46,2	—	386,8	1603,1
158,0	12,3	74,0	43,4	41,2	44,4	—	380,2	1867,4

the tax at the manufacturers level, the importers and exporters for goods introduced to, or exported from Argentina being responsible.

The rate applied to exports was inferior (3 °/₀₀) to the one corresponding to domestic sales (rate 1,5 °/₀₀). Only sales of goods but not of services were taxed.

The final incidence was recognized in the parliamentary debate to fall on consumers, but Minister of Finance F. Pinedo, sustained that in its new form the tax did not affect the lower classes as the indispensable goods were exempt from taxation. [21])

This statement is true only up to a certain point, as only food products and coal were exempt but all kind of clothing were subject to tax. Besides, one of the fundamental characteristics was that not all but only those materials were exempt from tax which become physical parts (physical ingredients rule) of the finished product, a disposition against which serious objections can be made from the producers point of view.

With regard to resource allocation, discrimination made by the law was in favour of exports (which had to pay a lower rate) and

21) Session of December 20, 1934.

to the agricultural sector which evidently had not to pay a tax imposed on the manufacturers level.

Furthermore there is no provision in the Argentine law in case of direct sales by manufacturers to retailers or consumers. In this way intermediaries — one evil of Argentine's economic life — were even more encouraged.

On the other hand, taxation at manufacturers level must be considered as a positive step in order to get an efficient tax and even more so at the beginning, when the new tax was introduced in Argentine which before had no experience and its citizens no conscienceness of tax compliance. It has to be pointed out that already in the first law which created the Impuesto a las Ventas it received the value added form.

In spite of several measures taken, in 1932 the Government still faced the possibility of a deficit and in order to avoid it created by decree the Emergency Income Tax. After the Constitutional Government assumed power, the Congress approved the law with unimportant modifications and the tax was applied to incomes earned subsequent to 1st of January, 1932. By this law the schedular system was adopted and no compensation of profite or losses of different schedules was permitted. At the same time a progressive global tax was also introduced for amounts exceeding 25.000.— Pesos. By its creation the Revolutionary Government gave the country an important instrument which could have lead to a more progressive tax system. Nevertheless, in these years the Revolutionary Government (as well as its constitutional successor) had no such idea. Dr. Hueyo, Minister of Finance, emphasized the very low rates and the exemptions of the tax. "Under these conditions" — he added — "the education of tax administration and tax payer will be reached. The inconveniences of this tax is well known — easy tax avoidance and high cost of collection. The Impuesto a las Transacciones, on the other hand, has been considered by the actual Minister of Finance, of France, Dr. Flandin, after many years of experience, one of the most equitable, revenue bringing, and easy to collect taxes." [22]) The Minister claimed also that all classes had to contribute to emerge from the serious crisis. But in the first years direct taxes were less than 15 % of total revenues of the Federal Government. (See Table 7) The regressive character of the Argentine tax system was clearly indicated by Dr. Hueyo who said that with regard to the danger of diminishing revenues the situation was not catastrophic because the greater part of revenues comes from taxes on consumption which

[22]) Diario de Sesiones, April 18, 1932, To. I, page 239/248. In 1932 révenues from the tax on tobacco products alone were higher than the whole Income tax revenues.

TAXES OF THE ARGENTINE FEDERAL GOVERNMENT (1930—1943)

(Million of pesos)

	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943
Custom Duties . . .	352,5	313,5	286,1	305,0	297,9	323,6	312,5	405,8	367,7	320,5	271,1	216,6	192,3	126,9
Excise Taxes	106,8	108,2	150,8	120,9	130,4	112,4	137,3	162,8	166,7	172,4	170,1	177,5	185,5	195,0
Land Taxes	14,4	14,8	14,7	14,7	15,3	15,5	33,7	30,8	30,2	31,7	31,9	31,9	32,4	33,1
Income Tax	—	—	53,4	65,1	66,5	58,0	71,8	99,5	107,9	111,9	125,6	127,2	197,9	213,6
Sales and transactions tax	—	0,3	22,8	19,9	18,5	24,7	28,8	34,9	33,6	36,5	36,7	40,0	43,5	46,1
Stamp tax	48,9	45,0	50,3	48,1	59,5	60,6	55,8	63,1	62,9	63,0	64,6	65,9	71,2	73,2
Tax on trade, industry and professions . . .	12,3	12,8	13,0	11,9	11,9	12,5	18,4	2,5	2,1	2,5	2,4	2,5	2,5	2,6
Death Duties	—	—	—	—			18,8	15,9	17,2	17,9	15,3	20,9	26,1	30,5
Total . . .	534,9	494,6	591,1	585,6	600.0	607,3	677,1	815,3	797,2	756,4	717,7	682,5	751,4	721,0

Source: Based on statistics given by Facultad de Ciencias Económicas - Instituto de Finanzas Argentinas. -

cannot be disminished beyond a certain limit, direct land taxes and custom duties on goods without which the population can hardly exist. [23]) A few months after its introduction the Income tax law was modified and the schedular system was replaced by a global tax. The only discrimination maintained was that of earned income (so-called fourth category-income proceeding from personal labour) which was levied at a lower rate (3 % against 5 % on all other incomes). During the whole period the law went through minor modifications (raising of personal allowances, exemption of interest from public debts).

The Argentine law established the principle of the source of revenue and prevented in that way foreign branches avoiding taxation. Of course from the point of view of foreign Corporations, this system had the inconvenience that it gave origin to double taxation if the country of residence of the head office adopted another legal system, (in case of American Corporations they can deduct the amount of the Argentine tax paid from their American tax liabilities).

With regard to Corporations the first law (Law 11.586) adopted the same tax for them as for personal income, but the new law followed a completely different pattern.

The project presented to Congress recommended double taxation of companies and shareholders, but this part of the project was rejected. [24]) The final law followed on general lines the British Income Tax, [25]) i.e. a tax on undistributed profit and a tax on dividends distributed to shareholders. The company had the obligation to withhold at source the basic tax rate and the shareholders could deduct the amount withheld by the Corporation from their final tax liability.

In this way the tax levied on the Corporation's reserves could be deducted from the tax withheld when dividends were distributed.

Certainly no objection can be raised against this system considering the ability to pay principle; the difficulty was that many shareholders did not include the dividends in their income tax declarations and in that way avoided payment of the surtax. [26])

As an instrument of economic policy we can give the tax no good

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[23]) Diario de Sesiones, December 21, 1932.

[24]) Marcos Rabinovich "Las Sociedades Anónimas ante el Impuesto a los Réditos". Derecho Fiscal, 1955.

[25]) U. Hicks "Public Finance".

[26]) The Government tried to change the taxation of Corporate Profits by decree in order to avoid tax paid on undistributed profits being deducted from tax withheld on dividends distributed to shareholders. The Supreme Court declared this disposition unconstitutional. Furthermore the Court decided that dividents could only be taxed if proceeding from taxable income, in that manner capital gains and income from foreign sources were not subject to taxation when distributed as dividends.

marks, specially because of its low rates it would have been an illusion to change the regressiveness of the Argentine system or to influence economic development. Since 1940 projects were published by the Government which would have raised the rates of Income tax. In that year expenses exceeded revenues and as before the deficit of the budget seemed to be the problem when precisely this deficit contributed to diminish the unfavorable impact of reduced foreign trade on economic activity.

In spite of the low tax rate the proposals of the government were criticized in the strongest terms by the business world. Any idea of even the slightest income redistribution was rejected "the moment of division comes only when goods have been accumulated, only then the poor people can benefit in the highest degree from the effort of the luckier and more efficient... If the individual initiative is dead, we would fall into communist decay". [27])

In the following years new proposals were made. The projects can be praised not only from the equity principle, but also with regard to anticyclical policy. In these years the growing industrial activity, a favourable balance of trade and a diminishing supply created strong inflationary pressure.

At last, the new ideas penetrated in the government circles and in order to diminish demand the reduction of public expenditure and the increase of taxation were recommended by the government a year before its fall, [28]) but as we have stated before all attempts failed and only monetary measures were taken against inflation.

The government's purposes were to levy those exceptional profits which were caused by war. In that connection an excess profit tax was recommended. The government's proposal included the creation of an export tax. The idea which gave birth to that project was much sounder than previous tax reforms. The importance of taxes as a device to reduce excessive purchasing power was recognized. As the main exports were meat and grain, the government expected that the export tax, by diminishing the value received from export, would also diminish domestic prices or otherwise other measures could be adopted to reduce high cost of food to consumers.

In the field of administrative efficiency an important measure was the unification of Excise taxes, which eliminated the double taxation by Federal Government and the Provinces of several consumer goods. [29])

(To be continued)

[27]) Unión Industrial Argentina and Confederación Argentina del Comercio, dela Industria y de la Producción. "Estudio sobre el Anteproyecto de modificación de la Ley de Impuesto a los Réditos."

[28]) Ministerio de Hacienda, Proyectos financieros y económicos, 1941—1942.

[29]) Roberto A. Rennie, op. cit. page 70.

LA POLITIQUE FISCALE EN ARGENTINE

par Federico Julio Herschel et Samuel Itzcovich

RÉSUMÉ

Dans cet article nous essayons d'expliquer l'évolution de la politique fiscale de l'Argentine pendant ce siècle, en considération des trois buts principaux suivants:

1. l'effet sur le niveau général de l'activité économique;
2. l'effet sur la répartition des revenus;
3. l'effet sur l'allocation des ressources.

Les périodes de division choisies sont marquées par des événements politiques qui sont en étroite relation avec les changements apportés à la structure fiscale.

Première période: 1900—1930

En vue de maintenir le niveau général de l'activité économique, on pratiquait inconsciemment une certaine politique anticyclique, car l'accroissement constant du nombre de fonctionnaires publics amenait en même temps l'augmentation des dépenses du gouvernement. Cependant, les booms étaient accentués par cette politique.

Le côté dépenses du budget présentait les caractéristiques suivantes: les dépenses administratives se montaient à un tiers du budget fédéral, les dépenses militaires étaient relativement élévées et les dépenses sociales se chiffraient à 10 % les dix premières années de ce siècle pour augmenter plus tard (le domaine le plus important était l'éducation).

Le système fiscal était de caractère régressif et se basait essentiellement sur les accises et les droit d'entrée.

Deuxième période: 1930—1943

L'idée prédominante de la politique fiscale pendant cette période fut le maintien de l'équilibre budgétaire. Il n'y eut pas de changement fondamental dans la tendance des dépenses mais il y eut quelques investissements publics importants, à savoir la construction de routes et les achats de navires pour créer la Marine Marchande Argentine.

En vue d'atteindre l'équilibre budgétaire, de nouveaux impôts furent introduits pour faire face aux dépenses croissantes et à la baisse des ressources.

Une taxe à la production fut établie et peu après le gouvernement créa par décret un impôt extraordinaire sur le revenu.

Le but fut d'établir abord un impôt cédulaire qui fut ensuite complété par un impôt global. Plus tard le premier fut supprimé. Malgré l'importance de l'introduction de ce nouvel instrument de politique fiscale, le système fiscal argentin restait basé essentiellement sur des impôts indirects.

FOR THE APPLICATION OF LINEAR PROGRAMMING TO PUBLIC FINANCE

by ERALDO FOSSATI
Genoa

1. — The purpose of this note is to formulate a model for the application of linear programming to public finance. The particular formulation being tentative, it should be considered more from the point of view of its purpose than from that of its structure, which is subject to refinement and even to radical transformation.

Let us take the national income of a given fiscal year, and let us assume that the public administration considers this income as a *stock* from which it can make deductions through taxation. In other words, it can draw from this *stock* a *flow* of revenue which may be regarded as its *raw material*.

We are now in a position to formulate our problem in terms of linear programming, and so to construct a model which we shall call a *fiscal optimum model*. We postulate a static model which abstracts from the existence of any stocks of raw material inherited from previous fiscal year. Thus the demand for raw material can only be satisfied by current production. It is assumed that the relevant enterprise, i.e. the State, is a monopoly which seeks to minimize the cost of its activity. The activity of the State has as its purpose to satisfy given demands. There is a *flow* of *deductions* from the *stock* and a *flow* of *allocations* of these deductions to public service, which are measured in terms of the raw material.

We shall assume, furthermore, the existence of spatially distributed demands corresponding to the needs of different regions of the country for public services. Such demands are to be satisfied by the raw material that comes, in turn, from the different regions. The amount of national income required to satisfy the demand for public services is obtained from the stock (which originates in different parts of the nation) and is subject to the constraint of a maximum rate of flow of raw material. This maximum expresses the fixed limit of taxable capacity in each instance. We now introduce a unit cost of collection and a unit cost of transfer from one locality to another (including the cost of transfer within the locality of collection). We have now a production activity which has for its raw material the contributions taken from national income. It follows that the problem is to determine that quantity of raw material for a given fiscal year which meets the following conditions:

a) that it satisfy the demand exactly;
b) that it not exceed the limits of taxable capacity;
c) that it be the optimal quantity, in the sense that it minimize the collection costs and the transfer costs.

For the period under consideration the particular system of taxation and the prices of the inputs required are assumed to be constants. The costs of deduction of taxes from income are expressed in term of monetary units of constant value. The rate of deduction can vary from zero to the total amount of the stock, which constitutes the maximum.

2. — The model assumes the State to be composed of m contiguous regions, so that interregional transfers can be exactly defined. Assuming that each region may be at the same time collecting entity with respect to its stock and a demanding entity with respect to its requirement for public services, there will be m^2 transfers of raw material. The income may be deducted from the stock in n different ways (methods of taxation) in each region. Each region has, however, one fixed demand for raw material. This demand, as we have seen, must be exactly satisfied.

The *data* of the model are the following:
a) the regional demands for raw material;
b) the amount of stocks in their spatial distribution;
c) the unit costs of collection in each region;
d) the unit costs of transfer of the raw material from the regional stocks to the localities of demand for services.

The *unknowns* are represented by the quantities of raw material transfered from the various stocks to the various localities of demand for income.

The demands in the model are represented by a system of m equations:

$$D_q = \sum_{h} \sum_{r} x_{rq}^{(h)} \qquad \begin{matrix} (r, q = 1, 2, \ldots\ldots, m) \\ (h = 1, 2, \ldots\ldots, n) \end{matrix} \qquad (1)$$

where D_q is a given demand for income of the region q; and ${}_{rq}^{(q)}x$ is the number of units of income collected by method h in region r and transferred to region q. The income collected is considered a homogeneous good, so that the consumers are indifferent as to its origin. The quantity of income to be collected by any method of taxation is subject, as has already be noted, to the condition of ability to pay which in the model appears as a *constraint*.

In conformity with the usual notation of linear programming, the abilities to pay will be expressed by non-positive numbers and transfers by non-negative numbers. If no income at all can be

collected, the taxable capacity is equal to zero; it will be negative, if some portion can be collected.

The *constraints* of taxable capacity are represented by a system of *mn* inequalities,

$$h_q^{(h)} \leqq - \sum x_{rq}^{(h)} \qquad \begin{matrix}(r, q = 1, 2, \ldots\ldots, m)\\ (h = 1, 2, \ldots\ldots, n)\end{matrix} \qquad (2)$$

where $h_q^{(h)}$ is the non-positive taxable capacity through method *h* in region *q*.

The unit costs of collection are measured, as has already be noted, in constant monetary terms for the fiscal year considered. The unit costs are constant too for each particular method of taxation. A special unit cost exists for each method in each region.

It follows that we have *mn* homogeneous linear functions of total cost:

$$E_r^{(h)} = l_r^{(h)} \sum_q x_{rq}^{(h)} \qquad \begin{matrix}(r, q = 1, 2, \ldots\ldots, m)\\ (h = 1, 2, \ldots\ldots, n)\end{matrix} \qquad (3)$$

where $E_r^{(h)}$ is the total cost of collection exclusive of fixed costs corresponding to process *h* in the region *r* (the fixed costs being invariant with respect to the amount of collection, they exert no influence on the solution of minimal cost) and $l_r^{(h)}$ is the unit constant cost of collection of the process *h* in the region *r*.

The unit cost of any given transfer is represented as the sum of unit cost of collection and the cost of the process of transfer. [1]) Thus we have mn^2 unit costs, one for each possible transfer:

$$c_{rq}^{(h)} = l_r^{(h)} + g_{bz}^{(h)} \qquad \begin{matrix}(r, q = 1, 2, \ldots\ldots, m)\\ (h = 1, 2, \ldots\ldots, n)\end{matrix} \qquad (4)$$

where $c_{rq}^{(h)}$ is the unit cost of income collected by taxation process *h* in region *r* and transfered to region *q*, and $g_{rq}^{(h)}$ is the cost of transfering one unit of income (collected by the process *h* in the region *r*) from this region to q.

The unit costs of transfer are determined outside the model, and are therefore *exogenous* variables. They are considered constant

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[1]) As an approximation the two variables are here taken to be independent. In a forthcoming paper the significance of this assumption will be developed. The opportunity of this remark was suggested me by Professor William Jaffé of Northwestern University, to whom I am grateful also for helping to revise the English text.

irrespective of the amount and the distribution of the transfer effected. For the purpose of the model the unit cost of transfer is assumed to be an average of a complex of transfers from the locality of collection to the destination.

The *optimum* complex of transfers of raw material is defined as the complex for which the total cost of collection and transfer is a *minimum*. The total cost of collection and transfer is represented by the sum of single transfers each multiplied by its unit cost

$$K = \sum_{h\,r\,q} \sum \sum c_{rq}^{(h)} \cdot x_{rq}^{(h)} \qquad \begin{matrix} (r, q = 1, 2, \ldots\ldots, m) \\ (h = 1, 2, \ldots\ldots, n) \end{matrix} \qquad (5)$$

where K is the total cost of collection and transfer. The *optimal* complex of transfers must be chosen so as to minimize the total cost (5) satisfying the demand (1) and subject to constraint (2).

Now the problem can be easily presented in the typical form of linear programming, through pure formal transformations.

POUR LA PROGRAMMATION LINEAIRE DANS LA FISCALITE PUBLIQUE

par le Professeur Eraldo Fossati

RÉSUMÉ

L'auteur étudie la question de savoir si le recours à la programmation linéaire est possible dans les finances publiques. Il s'agit ici d'envisager le problème financier d'une manière tout à fait nouvelle.

On considère le revenu national par rapport à une année fiscale déterminée. Ce revenu représente pour l'Etât un *fonds* d'où il tire ses recettes (la matière première) par la taxation. On peut par ici aborder la programmation linéaire sur la base d'un modèle, qui est appelé le modèle de *l'optimum* fiscal. Ce modèle est fixé sur le principe de l'existence d'une entreprise monopolistique, l'Etât, qui s'efforce de rendre *minima* les coûts de son activité, qui a pour but de satisfaire des demandes données.

REPORT OF THE CEYLON TAXATION COMMISSION

by U TUN WAI [1])
Washington

The Ceylon Taxation Commission was appointed in October, 1954 to examine the incidence of taxation (both local and central), the suitability of the existing tax system for financing the development program and for reducing inequalities of income and wealth. The effects of the structure and level of income tax on capital formation and the use of taxation for dealing with inflation or deflation were to be examined. The Commission was also requested to make recommendations regarding modifications, if any, of the existing system and fresh bases of taxation.

The Report of the Taxation Commission 1954—55 [2]) is a well-written document and attempts to answer the questions referred to the Commission by the government. It makes use of all the available material and supplements the gaps and deficiencies by questionnaires and assumptions.

Although the Commission did make an attempt to cover local government taxation by including the subject in the questionnaire sent, the poor response on this matter and the fact it had also been referred to another Commission led them to drop the question from the report. [3]).

The report is divided into five parts. Part I is a general review of the economic background and of the revenue and expenditure policies of the government, while the remaining parts are devoted to a detailed examination of direct taxes, commodity taxes, land revenue and other taxes. There are 56 specific recommendations for increasing existing rates of taxation and the levying of new ones.

Development of the Revenue System

Ceylon's tax system prior to 1915 consisted of only import, excise and stamp duties. Export duties were introduced in 1915, to pay for Ceylon's contribution towards the expenses of the war, while

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[1]) U Tun Wai is a member of the staff of the International Monetary Fund. Opinions expressed are those of the author and do not necessarily reflect the views of the Fund.

[2]) Colombo: Ceylon Government Press, 1955, pp. 350.

[3]) The omission of local government taxation does not reduce the usefulness of the report because in Ceylon the receipts of local authorities are very small when compared with the revenues of the central government.

income tax was introduced only in 1932. Tax revenue rose from 60 per cent of total revenue in 1920—21 to 80 per cent in 1953—54. The major reasons for the growth of tax revenues are stated by the Commission to be: (1) growth of Ceylon's economy, (2) the increase in tax rates from time to time and (3) the diversification of the tax system as additional sources of revenue were tapped. It is not clear, however, why the mere growth of Ceylon's economy should cause a greater expansion of tax revenue as compared with non-tax revenue especially when receipts from government railways were about half total non-tax revenues in most years and it would be a fair assumption that the railway services expanded *pari passu* with the other sectors of the economy. The slower growth of non-tax revenue must therefore lie partly in the pricing policy of such government services as railways.

The Commission does not compare the growth of tax revenue with the growth of national income, presumably because for prewar national income data are available for 1938 only. Tax revenues increased from Rs. 42.2 million in 1920/21 to Rs. 88.3 million in 1938/39. There was probably no price increase and possibly some decrease over the period as a whole [4]) which means that real tax revenue grew at the cumulative rate at least of 4.2 per cent per annum. Output during these two decades could not have grown at this rate and therefore we may conclude that during the interwar years, tax revenues expanded faster than real national income in Ceylon. For postwar also the government has succeeded in taxing a larger part of output as compared with 1938/39, although this has been offset by a relative decline in non-tax revenue (see Table 1).

Another interesting development in the tax system is that indirect taxes exclusive of export duties [6]) have been declining in importance from 85.1 per cent of total tax revenue in 1920/21 to 40.9 per cent in 1953/54. Direct taxes, on the other hand, increased from 21.5 per cent of tax revenue in 1938/39 to an average of 27.6 per cent during 1953/54. Export duties have also increased in importance during the same period. The increase in importance of the di-

[4]) Actual statistics are not available for the whole period, but this statement is based on the fact that in 1938 both the export and import price index were about half that of 1926 (Source: Ministry of Finance, *Economic & Social Development of Ceylon* 1926—54) and the general belief that prices rose during 1921—26.

[6]) The Commission quite appropriately distinguishes export duties from both indirect and direct taxes. Insofar as Ceylon is in no position to influence the world price of its exports which is probably true of all exports except tea which amounts to about 34 per cent of world consumption), the export duty will fall mainly on the income of the domestic producer and as such resembles the income tax.

Table 1.

GOVERNMENT REVENUE AND GROSS NATIONAL PRODUCT

in million rupees.

Year ending 30th September	Gros National Product[5])	Total Revenue	In percent of Gross National Product		
			Total Revenue	Tax Revenue	Non-tax Revenue
1939	595	135	22.7	14.8	7.9
1948	2,627	601	22.9	17.9	5.0
1949	2,873	640	22.3	17.5	4.8
1950	3,840	691	18.0	14.0	4.0
1951	4,508	910	20.2	16.3	3.9
1952	4,420	954	21.6	17.4	4.2
1953	4,418	953	21.6	17.4	4.2
1954	4,696	1,026	21.9	17.5	4.4

Source: *Report of the Taxation Commission 1954—55,* p. 5 and United Nations, *Statistics of National Income and Expenditure,* Series H, No. 9 (May 1956).

Table 2.

INCREASE OF INCOME TAX RATES, 1938/39 TO 1953/54.

Type of tax payer and Assessable income in Rupees	Tax payable in rupees		Increase in tax payable as per cent of amount payable in 1938/39
	1938/39	1953/54	
A. *Resident individual with wife and two children*			
6,000	60	60	—
10,000	210	200	—4.8
24,000	1,500	2,300	53.3
50,000	4,950	11,200	126.3
75,000	9,450	25,200	166.7
150,000	22,950	83,200	262.5
250,000	40,950	168,200	310.7
B. *Resident Company*			
100,000	12,000	34,000	183,3
500,000	60,000	170,000	183,3
C. *Non-Resident Company*			
500,000	50,000	200,000	300.0
1,000,000	100,000	400,000	300.0

Source: *Report of the Taxation Commission 1954—55,* p. 11.

[5]) At factor cost and for calender year.

rect tax was achieved mainly by increases in tax rates so that by 1953/54 the rates were about two to four times that of 1938/39 for most brackets except the lowest ones. (See Table 2). The increase in importance of export duties was due to the re-introduction in the forties of a number of export duties abolished in the thirties, and the increase in rates effected during the Korean war boom.

Incidence of Taxation

The Commission's study of the incidence of taxation is limited to measuring the formal incidence, i.e. it ignores the possibility of shifting direct taxes and assumes that indirect taxes are borne entirely by consumers. The effect of subsidies and also of the benefits of other governmental expenditures on the incidence of taxation have been ignored. The study is based mainly on the material gathered by the Central Bank of Ceylon in the "Survey of Ceylon's Consumer Finances," 1953. The total number of households chosen in the Survey was 1,100 which works out to one household out of every 1,440 as compared with I spending unit out of every 18,330 in the annual consumer survey conducted by the Federal Reserve Board in the United States. Unfortunately, however, the material contained in the "Survey of Ceylon's Consumer Finances" is not particularly suitable for working out the incidence of taxation. The Commission makes amends for this deficiency by adopting certain assumptions most of which are reasonable while a few are not. It should be noted, however, that the alternative to making "unreasonable" assumptions would be to drop making the calculations of incidence of taxation.

To begin with, mention might be made of some of the more reasonable assumptions. In order to determine the incidence of taxes (import duty and excise) on liquor which vary with the type of liquor, it was assumed that foreign liquor, because of its high price, was consumed only by those in the highest income group and the import duty therefrom was assigned entirely to this highest income group. On similar grounds, the tax receipts of local beer were allocated only to the two highest income groups; consumption of arack was assumed to be widespread except for the highest income group and the revenue allocated to each group, except the highest, according to the pattern of outlay on alcoholic beverages. Toddy was assumed to be a poor man's drink and the duty collected from it apportioned only to the lowest four groups on the basis of their outlay on alcoholic beverages. Another example of a reasonable assumption is with reference to the excise duty on matches. The duty was allocated according to the consolidated expenditure on tobacco, kerosene, light and fuel.

Of the many assumptions made by the Commission regarding incidence, the ones relating to allocation of import duty, excepting liquor, are probably the least satisfactory. For example, the duty collections on barley, millet and other grains and on eggs were assigned only to the three highest income groups on the grounds that the lower income groups are likely to depend upon cheaper local supplies. This seems unreasonable as Ceylon imports food, especially grains, to satisfy the needs of the whole population and not only for the needs of the rich.

A more serious defect (in the calculation of the incidence) than unreasonable assumptions is the omission of many taxes because it was difficult to allocate them among the different income groups. The most important omission is that of export duties as it constitutes about 30 per cent of tax revenue. The difficulty of allocating export duties arose mainly from the fact that the avaiable data on income was net of export duties. The effect or all omissions, both justified and forced, reduced the coverage of taxes allocated to 44.4 per cent of total tax revenue in 1952/53.. The Commission, however, concludes on insufficient grounds that the coverage is high (79 per cent for 1952/53) by comparing the taxes allocated with the tax revenue excluding export duties and Excess Profits Duty. The exclusion of the latter duty can be justified as it no longer exists at present. But the exclusion of the export duty is a weakness as the prices of Ceylon's exports (except possibly tea) are determined by world demand conditions rather than by the amount supplied by it — the incidence of the export duty therefore is more likely to be borne by the producer in Ceylon than by the consumer abroad. [7]).

The broad conclusion of the Commission is that the tax system in Ceylon is progressive with more or less no change in the incidence between 1951/52 and 1953/54. The tax incidence falls lightly on the lowest income groups, but quite heavily on the highest. Those in the middle income groups were found to be taxed comparatively lightly (See Table 3). The progressive nature of the tax system in Ceylon stems mainly from three facts: (1) the progressive nature of the income tax; (2) the progressive nature of import duties as luxuries are taxed more heavily than necessities such as food; (3) the progressive nature of excise taxes which also have heavier rates of taxation on luxuries with certain exceptions.

The taxation system in Ceylon, therefore, has made the distri-

[7]) The Commission does use this and other assumptions to prepare a separate note on export duties and concludes that the pattern of incidence of total taxation (i.e. including export duties) is the same as the incidence of taxes other than export duties. But the assumptions used in working out the incidence of export duties are even less tenable than those made for other taxes.

Table 3.

DISTRIBUTION OF INCOME BEFORE AND AFTER TAXATION, 1952/53.

Income of spending units in rupees	Per cent of Income Receivers	Cumulative Percentage of Income Receivers	Per cent of total Income		Taxes as per cent of average income
			Before Tax	After Tax	
0— 50	8.4	8.4	2.43	2.54	5.4
50—100	24.9	33.3	13.20	13.86	5.3
100—200	41.5	74.8	31.22	32.70	5.6
200—400	19.0	93.8	23.71	24.56	6.6
400—800	3.9	97.7	9.28	9.40	8.7
Over 800	2.3	100.0	20.16	16.94	24.3

Source: *Report of the Taxation Commission 1954—55*, p. 53.

bution of incomes more equal after taxation. It has been estimated by the Commission that the "coefficient of concentration" [8]) is 0.3950 before tax and 0.3604 after tax. Thus the reduction in inequality as a result of taxation is rather small being a reduction in the coefficient of only 0.0346.

The progressive nature of indirect taxes in Ceylon and in some other underdeveloped countries [9]) leads one to believe that indirect taxes in all underdeveloped countries are progressive, in contrast with the situation in the developed countries where they are generally regressive.

Government Finance and the Trade Cycle

Ceylon is rather dependent on foreign trade and its exports amounted to 34 per cent of the Gross National Product in 1953. Government revenues have therefore varied with the fortunes of the general trade cycle and particularly with the changes in prices of commodities exported by it. The government's dependence on the trade cycle is increased by the fact that the prices of Ceylon's ex-

[8]) The coefficient of concentration used is what is generally known as Gini's coefficient of concentration calculated on the basis of the Lorenz curve. The coefficient is the ratio of the area between the curve and the line of equality to the area of the triangle below the line of equality. As the degree of inequality in income distribution approaches infinity the coefficient would approach I while as income distribution tends toward equality the coefficient would tend towards zero.

[9]) In India, as per findings contained in the *Report of the India Taxation Enquiry Commission 1953—54* (New Delhi, 1955) and in El Salvador for 1946 in Henry C. Wallich and John H. Adler, *Public Finance in a Developing Country* (Cambridge, Mass. 1951) pp. 132—134.

ports (except possibly tea which constitutes 34 per cent of world consumption) and imports are not subject to control or much affected by policy decisions or events in Ceylon.

The experience of Ceylon during the Korean boom and collapse was largely typical of many underdeveloped economies. There were fluctuations in certain items of government revenue resulting mainly from the fluctuations in prices of export commodities and partly from the quantitative changes in production and export.

The fluctuations of government revenue, however, were reduced by the time lag in the collection of income tax. Thus when export revenues were rising in 1950 and 1951, income tax receipts hardly rose. But when export revenues were declining in 1952 and 1953, receipts from income tax levied on incomes earned in 1950 and 1951 were instrumental in offsetting the decline in receipts from export duties.

The time lag between changes in private incomes and expenditures on imports was also another stabilizing factor on government revenues. Since demand for imports did not rise or contract immediately, receipts from import duties increased with a small time lag and were maintained at a high level even after the boom had collapsed.

For developed and closed economies, it is possible to advocate a counter-cyclical policy to maintain aggregate demand through budget deficits in recession and budget surpluses in booms. For underdeveloped countries especially with a large foreign trade sector as in Ceylon any conventional compensatory policy in a recession will only lead to a worsening of the balance of payments deficit caused by the fall in export prices. In Ceylon, as pointed out by the Commission, the balance of payments deficit in 1952/53 was increased because of the government dificit.

The Commission s recommendations regarding an appropriate fiscal policy for Ceylon during a trade cycle are very good and may be applied to most underdeveloped countries experiencing export booms and collapses. The main recommendation is that the government should siphon off the greater part of any increase in income created by an export boom through export duties and Excess Profits Taxes. In fact the Commission feels that export duties are far superior to income and profits taxes insofar as the latter suffer from the defect that they are usually levied on the income of previous years. In the words of the Commission, "Income and profits taxes can be used; but they suffer from the defect that they are levied on the previous year's income. Incomes and expenditures can therefore rise for some time and cause inflation before those taxes begin to curb expenditures. With an export duty, on the other hand, the

government is able to prevent part of the rising incomes from getting into the hands of the producers." [10]).

The Commission, however, qualifies its recommendation by saying that the government siphoning off of incomes during the boom may mean a reduction in the amount of funds available to the private sector for development.

But the advantages of siphoning off incomes in the boom are not only the prevention of domestic inflation but also the building up of cash reserves in foreign exchange. These foreign exchange reserves can then be utilized in times of depression when deficit financing would become necessary to sustain the tempo of developmental expenditure and to take care of a sudden falling off of tax revenue. In this way an underdeveloped and open economy could follow a modified form countercyclial policy and engage in deficit financing without inflation.

This modified policy is commendable even though critics might say that the government not spending to the fullest extent in times of prosperity would restrict the pace of development. The "sin," if any, of not spending to the fullest extent is nothing compared with the "sin" of initiating difficult and costly projects which cannot be completed because adequate financial resources both domestic and foreign are not available to carry the project to completion. The recent history of underdeveloped countries has many examples of projects half completed or delayed because sufficient foreign exchange resources were not available.

Taxation and Economic Development

The Commission was handicapped in its examination of the suitability of the tax system in relation to the financial needs of the government's development program because only provisional figures of proposed development expenditures were available and no estimates had been made of the maintenance cost and current expenditures incidental to the implementation of the program. Nor were estimates available regarding the likely behavior of non-developmental expenditures over the period of the plan.

The Commission makes estimates of the financial resources likely to be available to the government by way of current revenue and domestic borrowings but does not explain the methods by which they are derived. With the provisional figure of Rs. 2,160 million as the developmental expenditure, during 1954/55 to 1959/60, it estimates that the government budget position would vary between a deficit of Rs. 249 million and a surplus of Rs. 201 million. But considering

10) Report of the Taxation Commission (Colombo, 1955), p. 111.

that the final planned developmental expenditures of the government for 1954/55 to 1959/60 were later calculated to be Rs. 2,529 million, the deficit is likely to be larger.

The Commission also enquires into whether private capital formation in Ceylon is adequate and whether any inadequacy could be attributed to the level of taxation. The analysis is based on the level of capital formation shown in national income statistics and on a special questionnaire circulated by the Commission. The response to the questionnaire was rather poor — the coverage for all companies being only 20 per cent. [11]). The Commission concludes, on seemingly insufficient evidence, that the private investor in recent years has had justifiable grounds for complaints both as regards import duties and also tax aspects of government policy. It does qualify by saying that the task of mending ways still rests with the investors who appear to be unduly cautious and keen on quick returns.

One factor which supports the Commission's indictment of government action is that despite all the latter's policy statements regarding encouragement for investment and industrialization, about 60 per cent of capital goods imports pay an average import duty of 21 per cent and another 17 per cent pay an average duty of about 90 per cent. Only 23 per cent of capital goods imports enter the country with an average duty of 5.6 per cent. For raw material imports also the situation is similar though not as serious. About one-quarter of the raw material imports enter the country at an average import duty of 8 per cent and another 51 per cent of raw material imports enter with a duty of 21 per cent.

Certain other findings of the Commission regarding capital formation and savings should cause no surprise to students of underdeveloped countries. For example, net investment (as stated by 166 companies in their replies) during 1948—53 constituted the major portion of gross investment.

The fact that about 45 to 55 per cent of gross investment of tea, rubber and coconut companies consisted of investment in building while in manufacturing the percentage was 22 does seem peculiar. As regards savings, it was to be expected that it would be low and that this low level was one of the important factors for the absence of proper capital markets which in turn forced most companies to finance their gross investment by ploughing back their profits.

The Commission, without adequate evidence, has made certain statements regarding the effect of taxation on investment. It concludes that lower taxes will be reflected in greater savings in the

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[11]) The coverage varied with the type of company from 10.5 per cent in the construction business to 77 per cent in the case of tea.

private sector as a whole. Apart from the question of evidence, any analysis of the effect of taxation on private savings should not ignore, as done by the Commission, the existing level of government savings (government current revenue less current expenditure on goods and services) which would also be affected by a lowering of the tax rates. The Commission also concludes that private investment (in the company sector) has been lower as a result of the high corporate taxes. While this seems possible, it should be emphasized that lower corporate taxes may result in larger dividends being declared.

Direct Taxes

We shall now consider some of the 56 recommendations made by the Commission for introducing new taxes and raising some of the existing ones. It also reviewed and rejected a large number of suggestions from various persons and organizations.

The majority of the recommendations of the Commission including those relating to direct taxes were adopted by the Finance Minister in his budget proposals for 1955/56. His main reason for not adopting all the recommendations was the desire to have the public express views on the findings.

The 1955/56 budget proposals for fresh taxation were classified by the Finance Minister into three broad groups; (1) incentives designed to encourage savings and capital formation in the private sector, (2) proposals designed to change the existing income tax law relating to the concept and determination of income, and the law and administration of the taxes and (3) pure revenue proposals designed to reduce the budget deficit as far as possible. Although the classification has conceptual merits, some of the changes recommended under group two would also help to reduce the budget deficit. We shall therefore consider the recommendations of the Commission according to more common headings of direct taxes, commodity taxes, and land revenue and other taxes.

Direct taxes are important in Ceylon (27.6 per cent of total tax revenue in 1953/54) and consist of two taxes on income, namely, the Income Tax and the Profits Tax, a death duty in the form of an Estate Duty and a variety of stamp duties on documents. Of the direct taxes, the most important one is the Income Tax which in 1953/54 accounted for Rs. 155 million out of a total of Rs. 237 million collected by the government through direct taxes as a whole. Collections from the Profits Tax amounted to Rs. 60 million while those from Estate Duty and Stamp Duties were rather small.

The Income Tax was introduced in 1932 and, basically, the system has remained unchanged. Broadly speaking, Income Tax is

charged on all income which arises in Ceylon and on all income arising abroad to persons (including companies and bodies of persons) resident in Ceylon. A Double Taxation Agreement between Ceylon and the United Kingdom, however, lays down rules to avoid double taxation of income arising in one country to a resident of the other country. As regards the other Commonwealth countries (except India) the Income Tax Ordinance provides that if income is charged to tax both in Ceylon and in other Commonwealth countries, Ceylon will reduce its tax charge provided the other country gives a similar reduction from its own tax.

The income tax is graduated in the case of individuals with an exemption limit of Rs. 4,800. All incomes above the exemption limit are liable to a minimum liability of 1½ per cent of the total income. Subject to the minimum liability the graduation is effected by means of personal allowances which depend on the family responsibilities of the taxpayer and which exempt the first slice of income. There is a progressive scale of rates of tax applying to further slices of income and differentiation is made between earned and unearned income.

The Profits Tax which was introduced in 1947 replaced the Excess Profits Duty introduced in 1941. The Profits Tax applies to agricultural, professional and business incomes of persons (including companies and bodies of persons). It is charged on that part of the income which exceeds Rs. 50,000 or 6 per cent of the capital employed, whichever is the greater. The rate of tax was originally 20 per cent but was increased to 25 per cent in 1950.

The Estate Duty was introduced in 1919 which was levied on the value of the property of a deceased person. Originally the duty was levied on estates as small as Rs. 1,500 ($ 315) but later amendments raised the value of exemptions till 1947 when estates valued at less than Rs. 20,000 were exempted. The rates in force at the time of the enquiry varied from 3 per cent on an estate valued between Rs. 20,000 and 50,000, to 40 per cent on estates worth more than Rs. 15 million. Stamp Duties were introduced in 1909 and are now levied on all kinds of documents including checks, mortgages, conveyances or transfers of stocks, shares, and debentures, deeds of gifts etc.

Of the recommendations, relating to direct taxes adopted by the Finance Minister in the 1955/56 budget, mention might be made of relief from income tax for payment of insurance premia and contributions to approved provident funds up to Rs. 4,000 but not exceeding $^{1}/_{6}$th of the assessable income. This measure was meant to encourage private savings. To promote capital formation in the private sector, the Finance Minister accepted the recommendations

to increase the initial allowances in respect of plant and machinery from 15 to 25 per cent and in respect of industrial buildings from 10 to 15 per cent. Reductions were also made in customs duties on imports of certain building materials and machinery to encourage private investment.

Many modifications were made in the income tax law as a result of the Commission's recommendations. In the 1955/56 budget, the rate of minimum liability to tax was reduced from 1½ to 1 per cent where the assessable income does not exceed Rs. 6,000, but where the assessable income exceed Rs. 6,000 the minimum liability rate was increased to 2 per cent. Exemptions from income tax for religious institutions were limited to such amounts as actually spent on charitabe or religious purposes. Various loopholes in the Income Tax Law, through which businessmen had evaded paying income tax, were also closed; for example the definition of "profits from employment" was amended to include, as income liable to tax, the costs of conveyance or any allowances for the purchase of any conveyance. Expense allowances in the case of directors and senior executives were included in the total "profits from employment" and only the actual expenses for the purpose of business were to be deducted. Various amendments were also made affecting the law and administration of the Income Tax. In cases of false returns, the Commissioner of Income Tax was empowered to impose penalties up to a limit of Rs. 2,000 and twice the amount of tax evaded by such false declarations. Furthermore, in the prosecution of income tax cases, false returns or statements which the taxpayer knows or believes to be false were to be brought within the scope of the penal section of the law. The size of the staff in the Income Tax Deparment was to be increased to cope with tax evasion. In the 1955/56 budget, the Estate Duty in respect of estates between Rs. 20,000 and Rs. 75,000 remained unchanged but the duty for estates above Rs. 75,000 were raised slightly and the highest rate of 40 per cent was made applicable to estates of over Rs. 10 million as compared with over Rs. 15 million before.

It might be of interest to take up some of the important issues in the field of direct taxes which were considered by the Commission. In 1953/54, income tax in Ceylon was paid by approximately 44,000 resident individuals which represents, roughly one-half of one per cent of the total population. The Commission considered the question of lowering the exemption limit from Rs. 4,800 to Rs. 2,400. It was estimated that this would make another 50,000 resident individuals liable to income tax, which illustrates the desirability of lowering the exemption limit. The Commission, however, was cautious in its recommendations and felt that the exemption

limit should be lowered only when the Income Tax Department was ready to take on the additional work involved. Apart from this qualification there can be no question that exemption limits on income tax in Ceylon as in many other underdeveloped countries are rather high in relation to the per capita national income. Thus in Ceylon in 1953, a person with a wife and three dependent children has to earn 14 times the national per capita income before being liable to income tax in contrast with the situation in the United States where the same person would be liable to income tax as soon as he earned 1.4 times the national per capita income.[12]). The basic exemption limit of Rs. 4,800 of $ 1,000 for a single individual is also much higher than the $ 600 exemption in the United States.

On the question of collecting income tax promptly, the Commission did not recommend collection of income tax quarterly in advance (on the basis of the tax payer's estimate of income likely to be earned in each quarter) because of the practical difficulties. The scheme, however, might be considered by the Income Tax Department when is has succeeded in clearing up the backload of work. But the Commission should have recommended that deduction of income tax on wages and salaries (i.e. pays-as-you-earn) be made compulsory by law, as in other countries such as the United Kingdom and India, instead of the existing arrangement whereby deduction is at the option of the tax payer.

The Commission argued, not too convincingly, that relief from taxes for certain initial periods i.e. "tax holidays" for the purpose of encouraging investment are not as effective as larger initial or depreciation allowances or the use of subsidies and guarantees. But the witnesses (business men included) gave conflicting evidence; some said that "tax holidays" were not so attractive as substantial allowances which enabled them to write off the capital investment quickly, while others favored "tax holidays." The Commission, however, did not recommend the withdrawal of "tax holidays."

The Commission felt that the problem of tax evasion was quite serious especially as the Income Tax Department was inadequately staffed. It was estimated that an income tax official needed at least 10 years experience to detect false statements in income tax returns. Of the 85 assessing officers in the department only 24 had had more than 10 years experience. Although Ceylon has problems in collecting income tax it seems to us that they are not as serious

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[12]) The relevant ratios for other underdeveloped countries in Asia are 20 times the national per capita income in Burma, 14 times in the Philippines and 11 times in India (1950). Source: ECAFE paper on "Development Policies and the Means for Implementation of Development Programmes, with Special Reference to ECAFE Countries" ECAFE/DPWP. 2/2. 26 July 1956) p. 70.

as in other underdeveloped countries in view of the fact that Ceylon has succeeded in raising about one-fifth of its total tax revenue through income-tax.

Commodity Taxes

Of the commodity taxes, *customs duties* have yielded the largest revenue varying between 50 and 75 per cent of total tax revenue during the last three decades. In postwar it has generally contributed about 60 per cent of total tax revenue. The variations have resulted from a number of factors; between 1920/21 and 1925/26 revenues from customs duties increased because of the increase in tariffs in 1922 and the increase in the volume of trade. During the thirties, it declined in importance as all export duties except that on tea were abolished, and also because the revenue from direct taxes increased rapidly after the introduction of the income tax in 1932. In the forties, the importance of customs revenues was restored mainly because of the re-introduction of the export duties.

Ceylon's *import duties* in the years immediately following World War I were at a rather low level of 7½ per cent. In 1922, due to financial needs, the general import tariff rate was raised to 10 per cent ad valorem except on certain locally produced articles. The next major change in import tariffs was made in 1933, when in accordance with the Ottawa Agreement, preferences were given to certain goods manufactured in the United Kingdom or the British Empire. Care was taken, however, that the preference did not adversely affect local prices and local industries. Thus the rates of duty on most foreign goods were raised leaving those on goods from the British Empire unchanged. The import duties on goods where the total demand could not be satisfied from British Empire sources were reduced in favor of British Empire goods.

According to the Commission, postwar taxation policy, especially since 1948 has been guided by considerations of correcting adverse balance of payments, reducing the cost of living, encouraging local industries and collecting larger revenue to finance the rapidly increasing expenditures, both developmental and non-developmental.

These different objectives, if carried out too far, are in conflict with one another. But in Ceylon it has been partly reconciled by the fact that in certain years more emphasis has been given to one or more of these objectives and in other years to other objectives. Thus, for example, between 1948 and 1950 considerations of protecting local industries were probably more dominant while between 1950 and 1952 import duties were reduced to check the rising cost of living. Since 1952 revenue considerations have dominated tax policy.

At the time of the Commission's inquiry the level of import duties

were around a basic rate of 17½ per cent preferential and 27½ per cent general while some luxury articles were taxed at 125 per cent, which was much higher than the level prevailing in the twenties. The average incidence of import duty on trade as measured by the percentage of import duty revenue to total import trade was only 6.1 per cent in 1920/21 but by 1938/39 it had risen to 21.8 per cent. In postwar years it has been around 16 to 17 per cent because the specific import duty rates have not kept pace with the rising unit value (prices) of imports. In addition, the contribution of import duty to total tax revenue has declined from 58.7 per cent in 1938/39 to 29.7 per cent in 1953/54.

The Commission devotes considerable attention to the possibility of changing the duties on imports to increase revenue. It analyzes the composition of imports and the revenue obtained from each category such as (1) rice, other grains and flour, (2) cotton yarn and piece goods, (3) kerosene, oil, etc. In 1953 the revenue from import duties on rice, other grains and flour, motor spirits, tobacco and cigarettes, accounted for 55 per cent of the total revenue from import duties. It also classifies imports by the kind of duty levied into six broad groups namely, (1) goods liable to specific duties, (2) goods liable to ad valorem duties of less than 10 per cent, (3) goods liable to ad valorem duties of 10 to 30 per cent, (4) goods liable to ad valorem duties of 30 to 50 per cent, (5) goods liable to ad valorem duties of over 50 per cent and (6) duty free goods. Within each category of duty levied, the commodities are further classified into ordinary consumption goods, luxury consumption goods, raw materials and capital goods.

In studying the possibilities of increasing revenue from import duties, the Commission was guided by certain principles namely, (1) items of ordinary consumption should be taxed at a low level except where protection of a local product is necessary, (2) items of luxury consumption should be taxed at a high rate and (3) raw materials and capital goods required for local industries should be imported free of import duty or at very low rates.

After carrying out the above analysis the Commission concludes that increased revenue cannot be obtained from items subject to specific rates of duty without abandoning the principles of equitable taxation. For the category of goods where import duty was levied at an ad valorem rate of less than 10 per cent, (in which group ordinary consumption goods account for 60 per cent) it recommends that the average incidence of duty on cotton goods be increased from 7.3 per cent to 10 per cent. It felt that this would yield a moderate increase in revenue without appreciably increasing the prices of cotton textiles.

For goods imported at an ad valorem duty of between 10 to 30 per cent, (in which group capital goods account for 46 per cent) it recommends that the list of capital goods and raw materials should be examined with a view to reducing the duties on those goods which are required for local industries. It also observed that a large number of luxury goods falling within this third category are bound by the General Agreement on Trade and Tariffs *(Gatt)* and that the limits had been reached in all except the food items, domestic refrigerators, artificial silk, embroidery thread and a few small items. On all of these exceptions, apart from foodstuffs, it felt that there was scope for increasing duties.

For the category of goods imported at an ad valorem duty of 30 to 50 per cent (in which group luxury consumption goods account for 89 per cent) the Commission felt that it would be possible to raise revenue by increasing duties. But here again, most of these items, except biscuits, are bound by *Gatt* and the limit reached. Therefore, the prospects of increased revenue from this group were felt to be very limited.

The value of the goods imported at an ad valorem duty of over 50 per cent was so small that the Commission correctly felt that no substantial increase in revenue could be expected from an increase in duties. On goods entering free of duty, which in 1953 amounted to 17 per cent of total imports, the Commission argued that the items did not offer scope for additional taxation because most of them could be classified as essential goods. This conclusion, however, is subject to question because milk products, which are imported free of duty and considered to be essential are certainly not more essential than imports of rice, other grains and flours which were subject to an average import of 19 per cent in 1938 and 4 per cent in 1953.

The Commission does not make any detailed study of Commonwealth Preference and *Gatt* partly because of the lack of time and partly because it was outside the scope of its terms of reference. It might, however, have recommended the appointment of a separate commission to determine the precise advantages and disadvantages of Commonwealth Preference to Ceylon. With reference to *Gatt*, it is interesting to note that 51 per cent of Ceylon's imports from *Gatt* countries and 52 per cent of its exports to such countries are bound by limits under the Agreement. [13]). Although maximum rates of import duty are laid down for only 125 out of more than 2,000

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13) Imports covered under the G a t t accounted for 12 per cent of the total value of imports and exports covered 20 cent of the total of exports in 1953.

items in the custom tariffs, Ceylon has reached the limit of taxation on all but 30 items.

The significant *export duties* at present are those on tea, rubber and coconut products. In the years following World War I, export duties were very low, and even these were mostly abolished in the thirties. In the forties, export duties were reintroduced and its contribution to total tax revenue increased from 3.7 per cent in 1938/39 to 29.1 per cent in 1947/48. During the Korean war boom a system of sliding scale export duties was introduced but owing to difficulties, the ones (sliding scale) on tea and coconut products were abandoned in December 1953, while the duty on rubber ceased to slide because of the low prices.

The Commission in discussing export duties felt that the sliding scale system should be reintroduced as soon as the administrative difficulties could be solved. It considered, but was generally not convinced by the arguments against the system namely: (1) it had resulted in a loss of revenue, (2) the facility of optional registration enabled shippers to send out their exports at the lowest rate of duty, (3) it introduced an element of speculation in the local market, (4) it discouraged long term contracts and (5) in the case of tea, where the duty was arrived at by averaging the prices of all grades of tea, the duties discriminated against lower grades.

The Commission refutes most of these arguments, for example, with reference to the first one it points out quite clearly that the loss of revenue was the result of a lower level of prices; even with a system of specific export duties, the government would have been forced to reduce them when prices fell, and therefore revenue must be lower in a depressed year as compared with a prosperous year. Some of the other disadvantages were not the fault of the sliding scale system but the fault of the existing procedures of working the system. It concluded, however, that the existing system of specific export duties might be continued until conditions are more propitious for a radical change. It also recommended that the government should keep a careful and continuous watch over the movement of prices of commodities which are subjected to export duty so that firm and quick action might be taken to adjust the export duty to the general price trends. The Commission also considered some special problems connected with the levy of export duties on tea and coconut products and made a number of recommendations for a more efficient Customs Department.

The Finance Minister in his 1955/56 budget accepted many of the recommendations concerning changes in the import duties but did not reintroduce the system of sliding scale export duties. The Finance Minister admitted the theoretical advantages of the system

of sliding scale export duties but felt that the practical difficulties outweighed the advantages. Furthermore, he pointed out that even in India where sliding scale export duties had been reintroduced for tea, the system did not have the automaticity and inevitability of the pure sliding scale system in force in Ceylon in 1952—53. He did admit, however, the need for keeping under constant review the level of export duties levied.

Excise duties, though not as important as customs duties, accounted for 6 to 8 per cent of the total tax revenue in Ceylon during 1950—54. Over 90 per cent of the excise revenue is derived from duties on "country liquor." The items of next importance are duties levied on matches and tobacco. Revenue from salt is not so important. The revenue from liquor is obtained by levying rents on toddy taverns, fees for tapping licenses, duties on manufacture of foreign-type liquor and other country spirits and also on profits from the sale of arrack.

The profits from the sale of arrack is derived by a government monopoly in the distribution. Arrack is manufactured both in the government owned distillery as well as in eight privately owned distilleries and in one cooperative distillery. The manufacture is carried out under excise supervision and the output varied according to demand conditions by controlling the number of trees licensed each year for each distillery. The government purchases the arrack at a fixed rate which takes into consideration the cost of production including the awards under the Workmen's-Compensation Ordinance and the profit of the distillers.

The Commission discusses the possibility of increasing the price of arrack by Rs. 2 per bottle to Rs. 12. Since the consumers' resistance is small, there would not be any drop in sales. It therefore recommended that the price be increased.

The Commission also recommended that license fees be levied from clubs in respect of consumption of liquor, an increase in fees on special arrack licenses issued to foreign liquor premises licensed for the sale of arrack, doubling the license duty on local beer, new excise duties on soap and tea sold locally and an increase in excise duty on matches. All these recommendations seem reasonable and likely to yield more revenue. The Finance Minister, in his 1955/56 budget, implemented the recommendations on increasing the price of arrack and on license fees in the production and sale of liquor. He did not, however, implement the other recommendations relating to matches, soap, tea and tobacco.

Ceylon does not have any *sales tax* and the Commission did not have time to make a detailed enquiry into the possibilities of introducing such a tax. It noted, however, that judging from replies to

the questionnaire, public opinion in Ceylon seems to be against its introduction for the following reasons: (1) the same amount of additional revenue could be raised if required through increasing customs duties on imported articles which constitute the bulk of commodities on wich sales tax could be levied and this would be cheaper and easier to administer; (2) sales tax lends itself to evasion more easily than customs duty and; (3) sales tax would mean an unjustifiable increase in the cost of living for the poor. The Commission was not impressed by these arguments and felt that sales tax had more elasticity than customs duties especially as the latter is subject to trade agreements. It further argued that it would be impossible to have excise duties on every article produced in the country and also pointed out other advantages of the sales tax. The Commission generally was in favor or introducing a sales tax but recommended that a comprehensive survey should first be made of the actual pattern of the retail trade and also of such important aspects as exemptions, administrative machinery, etc. before it is introduced in Ceylon.

Land Revenue and other Taxes

Land revenue is not an important source in Ceylon which is in general contrast to other countries of South Asia such as India, Pakistan and Burma where it is an important source of revenue. The reasons for the different developments are not too clear especially as Ceylon like the other countries mentioned were under British rule about the same time. The British did try to introduce a sort of land tax on coconut plantations to conform with the tax on grain lands, but owing to strong protests this tax was withdrawn in 1797 a short time after it was introduced. The British had also introduced a land tax as a means of commuting the services due to Ceylonese Kings on land held under the feudal system of land tenure and which services were inherited by the British. But even this tax which was mainly on low land was abolished in 1892. Since then the only direct land tax that has been imposed on cultivated private land is the acreage tax levied by some Village Committees and even this does not apply to paddy and chena lands. Therefore, the main source of land revenue today is derived from Crown land. Revenue from Crown lands is increasing with Government's Colonization Schemes for the development of the Dry Zone and the program of transferring Crown lands to peasants for cultivation. But the amount of revenue so far collected is negligible; in 1953/54 land revenue from alienated Crown lands was Rs. 1 million and the rent from leasing of Crown lands another million rupees as compared with the total tax revenue of Rs. 822 million.

It is surprising to note that the Commission does not review the possibilities of introducing a proper land revenue system or even an income tax on agricultural income. It did, however, make certain recommendations on increasing irrigation rates to cover the cost of irrigation works and generally expressed agreement with the principle of imposing betterment levies.

The other taxes of any consequence are the *betting and lottery taxes* and in this connection the Commission made some good recommendations on increasing the scope of the betting tax to bookmakers (to be licensed) "on" and "off the course" at a rate of 20 per cent. It also recommended an increase in the lottery tax to 30 per cent and to include crossword puzzles and prize competitions under the scope of the lottery tax. Other suggestions included raising of licence fees on motor vehicles by substantial amounts. The Finance Minister in the 1955/56 budget accepted the Commission's recommendations for raising licence fees on motor cars and lorries, but did not impose them at the high rates recommended. Most of the other recommendations of the Commission on betting and lotteries taxes were accepted and introduced by the Finance Minister in the 1955/56 budget.

RAPPORT DE LA COMMISSION FISCALE DE CEYLAN

par U Tun Wai

RÉSUMÉ

Le rapport de la Commission fiscale de Ceylan, nommée en Octobre 1954, contient 56 conseils précis pour l'accroissement des taux actuels d'imposition et la création de nouveaux impôts. Par suite du manque de données, ces conseils ne portent que sur la fiscalité du gouvernement central et non sur la fiscalité locale.

Avant 1915, le système fiscal de Ceylan se composait uniquement de droits d'importation, de droits d'accise et de droits de timbre. Des droits sur les exportations furent créés en 1915 et l'impôt sur le revenu en 1932. Les recettes fiscales se montaient à 60 % du total des ressources publiques en 1920/21 et à 80 % en 1953/54. Pendant ce temps, les impôts indirects, à l'exclusion des droits sur les exportations, rendaient de moins en moins. Toutefois, la Commission ne compare pas l'accroissement des recettes fiscales à celui du revenu national. En bref, on pourrait conclure que, durant l'entre-deux guerres, les recettes fiscales se sont accrues plus rapidement que le revenu national réel de Ceylan.

L'étude faite par la Commission de l'incidence de la fiscalité se limite à mesurer l'incidence formelle. Elle n'a pas tenu compte de l'effet des subventions ni de celui des avantages dérivant des autres dépenses publiques sur l'incidence fiscale. La Commission compense le manque d'informations par certaines hypothèses, les unes bonnes, les autres mauvaises, sur le comportement du consommateur. Une bonne hypothèse, par exemple, est, en établissant les taxes sur les alcools par groupes de revenus, de supposer que les alcools les plus coûteux sont consommés par ceux qui figurent dans les plus hauts échelons de revenus. Ce qui est encore plus regrettable que de mauvaises hypothèses, c'est d'exclure de l'incidence fiscale de nombreux impôts, tels, par exemple, les droits sur les importations qui constituent environ 30 % des ressources fiscales. En dépit de ces carences, la conclusion générale de la Commission, à savoir que le système fiscal de Ceylan est progressif, est probablement exacte. Cette progressivité est due à la structure progressive de l'impôt sur le revenu et à celle des droits sur les importations ainsi que des droits d'accise.

Comme le commerce extérieur présente une grande importance pour Ceylan, les recettes publiques ont varié suivant les phases du

cycle commercial et le prix des produits exportés. Ces recettes accusèrent de fortes fluctuations lors du boom de la guerre de Corée et de la crise qui s'ensuivit; ces fluctuations furent quelque peu attenuées par les retards dans la perception des impôts sur le revenu et dans l'accroissement des droits d'importation et de douane. La Commission a grandement raison de conseiller au Gouvernement de bloquer la majeure partie des accroissements de recettes que le boom des exportations a provoqués en matière de droits sur les exportations et d'impôts sur les super-bénéfices; ce conseil serait applicable à la plupart des pays sous-développés. Pendant la crise, le Gouvernement peut alors pratiquer une politique de déficit financier, pour soutenir les dépenses de développement et utiliser les réserves de devises étrangères, constituées durant le boom, pour payer les importations.

La Commission fut gênée dans son étude de la fiscalité et du développement économique par le fait qu'elle ne disposait que des prévisions du programme de développement élaboré. Elle estime que le secteur privé, ces dernières années, a eu de bonnes raisons de déplorer à la fois les droits d'importation sur les biens capitaux et les tendances fiscales de la politique gouvernementale.

La plupart des conclusions de la Commission ont été adoptées par le Ministre des Finances dans son projet de budget pour 1955/56. Certaines mesures fiscales furent prises pour encourager l'épargne, telles, par exemple, l'exemption de l'impôt sur le revenu des primes d'assurances ainsi que des versements à des fonds de prévoyance. Le Ministre des Finances a aussi accepté d'accroître les provisions pour dépréciation de l'outillage et des bâtiments industriels. La Commission a pensé que le problème de l'évasion fiscale était grave, surtout du fait de l'insuffisance des services administratifs chargés de l'impôt sur le revenu. Bien que les habituels problèmes de la perception de l'impôt sur le revenu se posent à Ceylan, il ne nous semble pas que la situation y soit aussi sérieuse que dans d'autres pays sousdéveloppés, car on a réussi à accroître d'environ 1/5 les recettes tirées de cet impôt.

Pendant les 30 dernières années, les droits de douane ont fourni la majeure partie des recettes fiscales, variant de 50 à 75 % du total. Bien que la Commission ait porté grande attention à la possibilité de modifier les droits sur les importations pour accroître les recettes, elle n'avait pas grande latitude en cette matière, étant donné que la plupart des taux sont fixées par la Convention Générale sur le Commerce et les Tarifs (G.A.T.T.). Quant aux droits sur les importations, la Commission a vivement recommandé la réintroduction d'un système d'échelle souple. Toutefois, le Ministre des Finances n'a pas accepté la suggestion.

Ceylan n'a pas d'impôt sur les ventes et la Commission n'a pas eu le temps de faire une enquête détaillée sur la possibilité de créer un tel impôt. L'impôt foncier n'est pas une importante source de recettes à Ceylan, contrairement aux autres pays de l'Asie du Sud, tels l'Inde, le Pakistan et la Birmanie. Il est surprenant que la Commission n'ait pas envisagé les possibilités d'introduire un système approprié d'impôt foncier ou même un impôt sur le revenu agricole.

THE ESTABLISHMENT OF THE INCOME TAX IN JAPAN, (A HISTORICAL AND SOCIOLOGICAL STUDY)

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The income tax is of comprehensive, quantitative, and subjective character and, in consequence, it is a modern phenomenon. Its successful establishment chiefly depends upon the level of the modernization of the country in which it is to be established. In Japan, however, the case was somewhat out of conformity with this principle. For in Japan the income tax was first established in 1887, when social conditions were still insufficiently modern, but it has nevertheless been developing successfully since. It is the aim of this essay to explain the peculiarities of its establishment with reference to the general principles of the income tax as well as to analyse the social conditions of Japan at that time. (First Chapter).

In the income tax of 1887, the Government adopted the individual lump-sum income taxation system, using individual returns. The rate was progressive on total income, and its maximum was 3%. As for the tax system itself, it was of quite modern nature. But the yield of the income tax was very trivial. At the beginning, the income tax of Japan was indeed of very slight importance as a revenue instrument. So the significance of its establishment lay in the possibility of modernization of the whole Japanese tax system. (Second Chapter).

Moreover, we may say the Japanese income tax has since been, at any rate, developing successfully. It is the purpose of our third chapter not only to analyse the factors of its success, but also to examine the peculiarities surrounding its introduction, connection these with the social conditions inherent in Japan.

First as to its introduction: The financial circumstances of that time were not so pressing as to be the decisive factor in introducing it. It was rather Finance Minister Matsukata's effort in modernizing the tax system that gave an impetus towards the establishment of the income tax.

There were many peculiarities in the establishment of the income tax in Japan. For example, the method of collection at the source by the schedule system was adopted in Matsukata's first draft of the income tax in 1884. But on the ground of technical difficulty in its execution, his draft was given up, and the system of lump-sum taxation by the taxpayer's return was adopted in the income tax law

in 1887. That is only one of the examples of such peculiarities. And these are explained mainly by the characteristics of the modernization of the social condition in Japan — for example, the fact that her modernization had been promoted to some extent only in social systems, while her social consciousness was not yet modernized.

We can enumerate the following circumstances as grounds of the successful — although not remarkably successful — establishment of the income tax under comparatively immature and peculiar social conditions.

(1) It was a sort of income tax that could be easily executed.

(2) There was a strong tendency among the people to be ready to hold in high esteem the governmental and official authorities. And the social consciousness of the people was so tepid that there was no danger of any objection arising against the income tax introduced by the Government. Since the Meiji Restoration, the high officials of the Government had already been trying to modernize many aspects of the political system before the modernization of the social conditions became ripe enough. So the people, as well as the officials, of the time could probably keep pace with the introduction of an income tax which was too advanced for the circumstances of Japan. For these reasons taken together, the establishment of the income tax was, to some extent, a successful development. (Third Chapter).

Chapter I

The Fundamental Problems of the Income Tax

The income tax was introduced into Japan in 1887, and has survived several reforms. Nowadays it plays the most important rôle in the national system. (In the national budget for the fiscal year 1956, the yield estimated from the personal and corporate income taxes is about 60 percent of the whole tax revenue).

In this essay I intend to deal with the origin and establishment of the income tax in Japan. I shall begin by explaining the following two points: the grave significance of our theme, which at first glance may be regarded as a trivial technical matter; and secondly the point of view from which it will be treated.

1) *The Fundamental character of the Income Tax (the Modernity of the Income Tax).*

In explaining these two points, we must have some common knowledge of the characteristic features of any income tax. I will give such an outline at the outset.

The income tax is given various definitions in fiscal science and

tax law. But, after all, there can be no doubt that it is a personal tax imposed upon income, and we need no further discussion of this fact. The imposing of a tax directly upon income, however, is not a trivial matter, but it has considerable significance. For "income" is an idea of modern origin, and is a distinctive phenomeon peculiar to the modern world. We must, therefore, try to comprehend the characteristic features of the income tax through inquiry into the nature of income. Then what is the fundamental character of the income tax? As an answer to the question, we may point out that the income tax is of 1. comprehensive, 2. quantitative, and 3. subjective or individualistic nature.

First, we consider the comprehensive nature of the income tax. From the point of view of modernity in taxation, it is of great significance that income should be the object of assessment. When we consider such modern economic activities as enterprise, civil service, and the management of commerce and industry from the personal standpoint, they are all activities aimed at earning income. So we may say that our income, in terms of a certain amount of money reflects the results of economic activities, which are different in quality. And these qualitative differences are shaded into the uniform and quantitative, once they are reflected by our income. It is evident, therefore, that to impose a tax directly on income, is no more than a comprehensive assessment upon the result of all sorts of economic activities. So income can be the source of all kinds of taxes. It may be said, after all, "Jede Steuer ist eine Einkommensteuer." [1]) But in the case of other sorts of taxes, the objects for assessment always include something qualitative. For example, the objects of excise or business taxes are closely connected with consumption or enterprise, and income is taken into account only in such connection. Thus, it is obvious that these taxes are nothing but partial taxation, from the point of economic activity as a whole. Therefore it many be said that its comprehensive nature is the first and most significant matter that characterizes the income tax.

Secondly, let us take up the quantitative nature of the income tax. This nature is, of course, connected closely with its comprehensive nature. The income tax is imposed upon a certain amount of money, and the object of income tax assessment is without any qualitative character. In other words, only income, which is expressed in terms of a certain amount of money, is taken into account in the assessment of the income tax, while some qualitative allowance is made, for instance, for the variety of business, the proceeds of sales,

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[1]) L. v. Stein, Lehrbuch der Finanzwissenschaft, 5th ed., II 2, Leipzig, 1886, P. 409.

the size of a shop, and so on, in regard to the business tax, or for the rank and the social position of a man, in regard to the poll and class tax. In the case of the income tax, any qualitative difference, such as we find in the source of income, is taken into account with only secondary importance. Viewed from the standpoint of the taxpayer, the aspect of the income tax stressing the amount of money means that every personality (including corporation) is immediately connected with the state, without any distinction or any restriction being made due to the difference of social rank or position. Or in other words, the modern characteristic features of the income tax are reflected in the fact that the ability of a person to pay, which is considered as the source from which taxes are levied, is represented immediately by a certain amount of money. It would therefore be permissible to say that the introduction and establishment of the income tax is the typical realization of the rationalization process of the modern world — in Max Weber's terminology — in the sphere of the tax system. For the income tax is related only to the difference of quantity, and anything qualitative in social and economic relations is forign to it.

Thirdly, we consider the subjective character of the income tax. The imposition of a tax on income implies that the state takes an interest only in the results of the economc activities of individuals. The state entrusts the individuals with economic activities, and the individuals carry them on, with a view to getting income for their own benefit, so that their activities are founded on their own calculations and upon the responsibilities thay assume. The assessment on income, thus, has a serious meaning in that the state permits individuals freedom in the exercise of economic activities. The income tax is the typical representation of economic individualism in the sphere of the tax system. Thus income proves to be a comprehensive expression of the results of the economic activities of individuals as well as of the national economy as a whole. Accordingly it turns out to be a synthetic expression of the economic capacity of the individual. "Damit ist die Einkommensteuer in ihrer Besteuerungsgrundlage als die subjektivste aller Steuern gekennzeichnet." [2]). The income tax, therefore, is a realization of subjectivism in the modern world.

From this brief survey of the income tax, we may understand that its fundamental character is comprehensive, quantitative, and subjective. It is only when these fundamental features have been brought to light, that the peculiarities of the income tax are com-

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[2]) A. Tautscher, Das Prinzip der Einkommensteuer und Ertragssteuer, Zeitschrift für die gesammt Staatswissenschaft, 101. vol., 1941, p. 91.

prehended as a whole. The average text book of fiscal science enumerates the following peculiarities of the income tax: — The income tax should be very impartially collected directly from its sources. And the assessment should be proportionate to the economic ability of the individual. So the income tax is highly adaptable to the principles of universality and equality of taxation and accordingly it is adequate to the political principles of modern democracy. Moreover we can afford technically to adopt taxation with progressive rates, to exempt from taxation the minimum of subsistence, to provide an earned income credit, and to make allowance for the difference of sources from which income is derived. And with these, we can make sufficient allowance for the differences of economic faculties — not for differences of social ranks — of individuals. Along with the development of social consciousness since the end of the 19th century, the income tax has been able to satisfy the necessity for social welfare, and also to adapt itself to the increasing financial demand which is an essential phenomeon in the modern state. In short, we may say that it has some elasticity and flexibility.

Those peculiarities mentioned above of the income tax are given in ordinary textbooks of fiscal science. But in fact they do not include all the many peculiarities which are generally accepted. It is a matter of course that we can completely understand the meaning of those peculiarities, only when we try to approach the problem by way of those three fundamental characteristics of the income tax. [3]).

Thus, I believe it has become evident that the income tax is modern and rational in its fundamental entity, and that it should play an exceedingly important rôle in the "Steuerstaat."

2) *Conditions for the Introduction of the Income Tax (Modern Society and the Income Tax).*

As the last paragraph may suggest, "income" itself is so distinctly a modern concept that the existence of a considerable number of rational and modern conditions is necessary for the actual establishment of the income tax system. What are those necessary conditions? I will give some: — separation between business and household economy; establishment of a market or money economy: distinction of profits from wealth; formation of a modern employment system in factories and government offices; development of rational business accounting; establishment of professional administrative organization for the imposition and collection of taxes; prevalence

[3]) Cf. M. Kimura, "Conditions for Direct Taxation", in The Annals of the Hitotsubashi Academy, vol. II, No. 2, Tokyo, 1952.

of economic liberalism, etc. With the existence of such conditions, the basic character of income can be realized, meaning that income becomes objectively measurable and in consequence the income tax has the possibility of enforcement. But to be more concrete, modern economic activities are so complicated and multiplex that the exact amount of income can not be ascertained solely through the tax office, even if such conditions are fulfilled. For this reason the assessment of income is carried out, in most case, with some assistance from individuals (by their returns). Also necessary will be some other conditions, such as a high level of morality which will prevent the taxpayer filing fraudulent returns; democracy, that will guarantee an amicable relation between the ruler and the ruled, prevent the misuse of legal power, etc. [4]). In short, it is only under a social and economic system which satisfies all these conditions that the income tax can possibly exist and have serious significance.

3) *The Significance of Inquiry into the Establishment of the Income Tax.*

Considered from the social-economic standpoint, the perfect realization of the income tax is dependent absolutely upon the establishment of modern bureaucracy, on the development of democracy, and on the formation of modern capitalism. [5]). Therefore, complete understanding of the origin and development of the income tax is made possible only through the apprehension of the interacting and complicated social relations of the times. Moreover, its introduction, I dare say ought to be regarded as a chain of the process of modernization and rationalization in European civilization. It is to this fact that attention has been called so particularly, and this is the reason why I put such great significance on the problem of the establishment of the income tax in Japan.

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[4]) W. Lotz, Finanzwissenschaft, 2d ed., Tübingen, 1931, p. 472.

[5]) As for the conditions for the origin and development of the income tax, I should have discussed the matter more strictly and developed it in more detail. I have enumerated, for example, the establishment of modern capitalism as one of the economic conditions for the introduction of the income tax. But, strictly speaking, the formation of "Hochkapitalismus" — to use Sombart's terminology — is considered to be the condition for introducing it. "In der Tat ist die Einkommensteuer in dem hier gemeinten Sinne ein Geschöpf — und zugleich ein charakteristischer Ausdruck — der als "Hochkapitalismus" gezeichneten Wirtschafts-epoche,... (Fritz Neumark, Theorie und Praxis der modernen Einkommensbesteuerung, Bern, 1947, p. 21). However, for the purpose of this paragraph it is sufficient to point out that the establishment of modern capitalism is one such condition.

4) *The Standpoint of this Inquiry.*

Lastly, I refer to the viewpoint from which to treat the problem of the foundation of the income tax in Japan. Here attention should be called to the fact that the general principles of the income tax, as mentioned above, can be valid only in the modern European world. Japan however, was a less advanced country and had some distinctive historical traditions different from those of European states. Politically, prior to the Meiji Restoration of 1868, there had been established a centralized feudalism. Economically, commercial capital had developed to a very low degree. And up to 1868, at any rate, Japan had experienced neither any bourgeois revolution, nor any industrial revolution; nor had she undergone the establishment of a modern state. We may well say that "Japan as recently as the early 19th century remained in a stage of economic development hardly more advanced than that of western Europe in the late middle Ages". [6]).

In its essence, the Meiji Restoration of 1868 was a political revolution with a view to destroying feudalism and establishing a modern state. This revolution, after all, was successful with ardent efforts to import the political systems of the advanced countries in Europe. As far as the social system itself was concerned, Japan came gradually to put on the appearance of a modern state. Her political system was turning toward bureaucracy, and her economy toward capitalism, although only gradually. But it was only twenty years after the Revolution of 1868 that the income tax was introduced. Generally speaking, therefore, the circumstances of Japan seemed immature for the introduction and establishment of the income tax. Nevertheless, the income tax introduced in 1887 has since gradually been improved, without any great difficulties and obstacles. At first glance this appears to be inconsistent with the general principle of modernity in the income tax mentioned above. Does the general principle need some revision, or has the income tax in Japan some special characteristic not included within the general principle? In order to answer these questions, it is proper not only to trace and examine the concrete phases of its introduction in Japan, but to bring to light its characteristic traits through the general principle mentioned above.

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[6]) Cf. W. Lockwood, The Economic Development of Japan, London, 1955, p. 3.

Chapter II

The Nature of The First Japanese Income Tax

In Japan, the Income Tax was first introduced with the promulgation of Imperial Ordinance No. 5, the Income Tax Act, March 23, 1887, which was carried into execution on and after July 1, of the same year. An introductory explanation will be given of the substance of the system.

1) *The Outline of the System.*

The purpose of the introduction of the income tax into the fiscal code of Japan was, first of all, to meet the ever-increasing expenditure of the Government, and, at the same time, to realize the equality of burden in taxation [7]).

The characteristic feature of the system was its method of assessment. A system of lump-sum taxation was adopted, and only individuals were made taxable while the income of corporations was exempt. The tax was imposed on the whole income of the head and other members of the family, only when its aggregate amount was ¥ 300 and over. Incomes of ¥ 300 and over were divided into five brackets, assessed at progressive rates on total income according to the following schedule:

incomes from ¥ 300	up to ¥ 1,000	pay 1 %
incomes from ¥ 1,000	up to ¥ 10,000	pay 1.5 %
incomes from ¥ 10,000	up to ¥ 20,000	pay 2 %
incomes from ¥ 20,000	up to ¥ 30,000	pay 2.5 %.
incomes of ¥ 30,000	and over pay 3 %.	

The taxpayers were individuals only, and consequently corporations were not taxed, so the full amount of corporate dividends was added up with the individual income. Those whose total income was ¥ 300 and over had to make a calculation of their own incomes, and file returns with the governors of their districts every year. In bief, the method of the calculation was as follows. Incomes from salaries, annuities, pensions, interest on bonds and debentures, and dividends were summed up in their full amount. In the calculation of income arising from business, expenditures necessary for earning it (such as national taxes, local taxes, purchasing costs,

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7) In his "Proposal to Introduce the Income Tax" (January, 1887) Masayoshi Matsukata, Japanese Finance Minister at that time, gives a clear explanation of the origin and purpose of the introduction of the income tax into Japan.

repair expenses, interest payable for the debt of the business) were deducted from the total revenue. The business income taxpayer had to file a return of his anticipated income for the year, the amount of which was estimated as the average of incomes secured during the previous three years. As for other sorts of incomes, it is very difficult to find articles providing for these, but as far as I know, the income of the previous year was the base on which the return was to be made. The income tax commissioners were elected from among the taxpayers, and they assembled to inquire into the returns and certify them. After this certification, the governor of each district computed the tax lablity and billed the taxpayer. The tax was paid twice in a year, in March and September. These above mentioned facts are the outline of the income tax when it was first imposed.

2) *Characteristics of the Japanese System at that Time and Comparison with Foreign Systems.*

From the point of view of today, the first income tax of 1887 was so immature that we may wonder what merits it had [8]). But the introduction of the income tax as early as in 1887 may be unconditionally said to have been progressive, seeing that it was only in a few advanced countries such as Great Britain and Italy that the income tax was levied as an ordinary national tax. Compare the Japanese income tax system at that time with those in Great Britain and Italy, and you will find some interesting difference. The characteristic points of the British income tax in those days were first that it was the schedule system and that it adopted stoppage at the source. And simultaneously, it ough not to be overlooked that, in principle, the rate was proportional. The Italian income tax of the time was primarily an income tax on movables, and it was much the same with the business tax in many respects. In

[8]) The shortcomings of the system are easily pointed out from the present standpoint. For example, taxable incomes were devided into as few as five brackets, assessed at progressive rates on total income; the rate was extremely low; corporations were exempted; insufficient allowance was made for the lower incomes (but, it can not necessarily be affirmed that the personal exemption at ¥ 300 was too low, when that is considered in connection with the living standard of the time in Japan. ¥ 300 was equivalent to about $ 220 or £ 45 in 1887). With all these shortcomings, however, no serious obstacles may have been brought about to the taxpayer, because the tax rate was exceedingly low. Nevertheless, in the system of progression adopted in Japan, there was an obvious anomaly. If we compare the income which was slightly in excess of ¥ 300, or the point at which the rate changed, with the income slightly below ¥ 300 or that point, we can see that, when the tax was subtracted from each income, the remainder was larger for the smaller income. But there were probably no provisions which mitigated this kind of irrationality.

Japan, on the other hand, there was adopted, the method of lump-sum taxation with progressive rates. Therefore, it would be permissible to say that Japan was more modernized in its system than Great Britain and Italy [9]).

3) *Revenue from the Income Tax.*

Now we shall consider the revenue arising from the income tax. In 1887, the first year of its imposition, the yield of the income tax was as small as ¥ 527,000. Strictly speaking, however, this amount was collected only during the latter half of the year. Assuming that the income tax had yielded revenue during a year, it would have amounted to some ¥ 1,054,000. The proportion of this figure to

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[9]) Needless to say, there are two ordinary methods of income taxation; one is the schedule system, in which the imposition on incomes is made separately for each income source, and the other is the lump-sum system, the object for imposition of which is the aggregate income of each taxpayer. Each method has its own merits and demerits, and we cannot rashly decide which is superior in practice. Theoretically, however, the incomes of a person are more comprehensively and more exactly expressed by lump-sum than by schedular system. And since the ability of a person to pay taxes is more exactly reflected in the lump-sum than in the schedule system, the former is manifestly more rational and modern than the latter. (Hanya Ito, "Zaiseigaku" or Public Finance, Tokyo, 1953, p. 86, 87.) As between progressive and proportional rates of taxation, it would be needless to explain that, in pure theory, the former is much more adaptable to the ability to pay than the latter. According to Seligman, Italy had been without either progressive or differential rates till 1894. (cf. Seligman, "Progressive Taxation", Princeton, 1914, p. 90.) So the rate of the income tax of Japan may be said to have been more appropriate to the ability to pay, and of more rational character than that of Italy. When we compare the rate of the income tax in Japan with that in Great Britain, it is manifest that the former was more adapable to the ability to pay, and consequently of more modern character than the the latter, from the purely theoretical point of view. But if we consider the actual effect, we find the case somewhat different. It is true that a proportional rate (3.3 %) was adopted in Great Britain at the time. But in Great Britain incomes falling below £ 150 were exempt and an abatement of £ 120 was granted on all incomes between £ 150 and £ 400. Such being the case, the proportional rate in Great Britain was much the same as a progressive rate in actual effect. In Japan, the first income tax law of 1887 clearly declared that the progressive rate should be adopted. However, taxable income was divided into as few as five brackets. Moreover the maximum rate was 3 %. Therefore, if we take into account the substantial effect, we can not easily decide which was more suited to the ability to pay; the proportional rate in Great Britain or the progressive rate in Japan.

The rates of the income tax of that time in Japan and Great Britain were as follows: —

income . . .	£ 45	£ 149	£ 151	£ 399	£ 401	£ 1,500	£ 3,000	£ 4,500
Japan . . .	1 %	1.5 %	1.5 %	1.5 %	1.5 %	2 %	2.5 %	3 %
Gt. Britain . .	—	—	0.6 %	2.3 %	3.3 %	3.3 %	3,3 %	3.3 %

(The figures of income were converted into £s sterling at the rate of 1 yen = 3 shilling.

the total fiscal revenue is barely 1.2 % and to the total tax revenue 1.6 % while the land tax, which had been, the greatest source of the tax revenue since the Meiji Restoration, yielded during the same year ¥ 42,150,00 the proportion of which to the total revenue was 45 %, and to the total tax revenue 64 %. These proportions show us manifestly that the income tax of the first year was of infinitesimal importance as a revenue instrument, compared to the land tax. The ratio of the number of the income taxpayers to the whole populations of Japan was barely 0.3 %. But now, after World War II, the ratio is about 11 %. Comparing the two ratios, we can not but wonder how remarkable a development Japan has made [10]).

4) *The Significance and Characteristics of the Establishment of the Income Tax in Japan.*

The first Japanese income tax was of little importance as a revenue instrument. Nevertheless, its introduction was by no means insignificant, for it indicated the possibility of establishing a rational tax system.

Here, it is interesting to note that during the period from its introduction till 1898, the number of income taxpayers and the

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For the comparison of the Japanese income tax in 1887 with those of foreign countries, I will also consider the American and the Prussian income tax. In the United States, during the period 1862—1872, a lump-sum income tax based on the taxpayer's return was levied in order to cover the expenditures of the Civil War, but it was fairly simple in its system. In Prussia, the "Klassen- und klassifizierte Einkommensteuer" (class- and classified income tax) was introduced in 1851, and was radically reformed in 1873. We shall briefly survey the reformed system. The classified income tax was assessed on individuals with incomes of 3,000 marks and over while the class tax was assessed on those with incomes falling below 3,000 marks. The class tax was divided into twelve classes, with a fixed amount of payment. Complete exemption was introduced for the so-called minimum of subsistence, which was fixed at 420 marks. The rate was heavier for the smaller incomes than the larger in the same class. The rate on the lowest income in each class ranged from five sevenths of one per cent to two and two thirds per cent. And thus it was to some extent progressive. The classified income class tax was so calculated that the rate rose to three per cent on the smallest income in each grade. Incomes were arranged in forty grades up to 780,000 marks; beyond this point the tax increased 1,800 marks for every 60,000 marks of additional income. (cf. Seligman, "The Income Tax," New York, 2. ed., 1914, p. 243—244). Thus the income tax in Japan and those in America and Prussia were on the same fundamental principles, that is to say, lump-sum taxation. As for the rationality of the rates, no great difference was observed between them. It may be the proper occasion to correct an error made by Seligman. Concerning the introduction of the income tax into Japan, he states: the income tax was created in 1887, *but the progressive rates were introduced somewhat later* (Seligman, "Progressive Taxation," p. 122). His explanation is clearly incorrect.

amount of the income tax revenue gradually increased, though the income tax system was not subject to any change [11]).

This is, in a sense, an indication that the income tax had been developing successfully since its introduction even if its yield was small compared with those of foreign countries [12]). It is a noteworthy

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10) From 1887 till 1898, the income tax remained under the same system, and no reform was made. Below are shown the proportion of the number of the income taxpayers to the whole population of Japan, and that of the income tax revenue to the total tax revenue.

year	Tax Revenue (a) (yen thousands)	Income Tax Revenue (b) (yen thousands)	$\frac{b}{a}$	Number of Income Taxpayer (c) (thousands)	$\frac{c}{\text{Whole Population}}$
1887	66,250	520	0.8 %	118	0.30 %
1888	64,440	1,060	1.6 %	129	0.33 %
1889	71,290	1,050	1.5 %	115	0.29 %
1890	66,250	1,080	1.7 %	115	0.29 %
1891	64,500	1,110	1.7 %	115	0.28 %
1892	67,170	1,130	1.7 %	117	0.28 %
1893	70,000	1,230	1.8 %	124	0.30 %
1894	71,280	1,350	1.9 %	129	0.31 %
1895	74,690	1,490	2.0 %	134	0.32 %
1896	76,380	1,810	2.4 %	151	0.35 %
1897	94,910	2,090	2.2 %	172	0.40 %
1898	97,620	2,350	2.4 %	195	0.45 %

11) cf. note 10, above.

12) Following two tables show the yields of the income tax in Japan and Great Britain.

Table A

Year	National Income (a) (yen millions)	Tax Revenue (b) (yen millions)	Income Tax Revenue (c) (yen millions)	$\frac{b}{a}$	$\frac{c}{a}$	$\frac{c}{b}$
1888—1892	1,165	66.93	1.09	5.9%	0.09%	1.4%
1893—1897	1,666	77.45	1.54	4.6%	0.10%	2.0%

Table B

Year	Tax Revenue (a) (£ millions)	Income Tax Revenue (b) (£ millions)	$\frac{b}{a}$
1887—1888	75.660	14.440	19%

Table A: The proportion of the national income to the income tax revenue (5-year average) in Japan.

Table B: The proportion of the tax revenue to the income tax revenue in Great Britain in the year 1887—88.

fact in itself that the income tax was introduced as early as 1887 in so backward an Asian country as Japan. Moreover it is worthy of wonder that the income tax system was of modern and rational character, and that at any rate, it was developing successfully, without meeting any remarkable obstacles and serious contracitions. For in those days the social conditions for its establishment were so immature that even if it were introduced there was great probability of its becoming a failure or substantially insignificant. How can we explain the phenomenon peculiar to the income tax of the time in Japan? The main purpose of the following chapter is to pursue this.

Chapter III

The Establishment of the Income Tax and its Social-Economic Background

The subject of our third chapter is to examine what were the factors that made succesful the establishment of the income tax in Japan. At the same time, it is intended to analyse the peculiarities of the introduction of the income tax, in connection with the social conditions of Japan.

First, we shall begin with the various factors that promoted the introduction of the income tax.

1) *The Financial Conditions of Japan at the Time.*

According to Fritz Karl Mann, the most important factor that affects the decision of the financial policy is the financial situation, which reflects the social and economic structures of the time. Both the effort of the ruling class to exploit the ruled, and passion for

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Source of Table B: Mallet, British Budget, 1887—88 to 1912—13, Londen, 1913, p. 253.

In Japan, on introducing the income tax in 1887, the expected yield was ¥ 1,200,000. But the actual yield for the latter half of the first year of its imposition was about ¥ 527,000. This sum, converted into the figure for a year, would be about ¥ 1,054,000. Therefore, the actual yield was nearly 87 % of the sum anticipated. This proportion in the first year may, any way, suggest that it was succesful to some extent. In Great Britain, W. Pitt at first expected the yield to be £ 10,000,000 on introducing the income tax in 1799. After taking every condition into account, however, he had to confess that in place of £ 10,000,000 which he had anticipated he could only expects to obtain £ 7,500,000. Nevertheless, the actual yield of the tax for the first year of its imposition was only about £ 5,800,000. Thus, the actual yield was only 58 % of the first expected amount, and 76 % of the revised. cf. A. Farnsworth, "Addington, Author of the Modern Income Tax," London, 1951, p. 12—19.

justice of the legislators, are influential only within a certain limit. He names this thesis „Die Gewalt der finanzpolitischen Entscheidung" [13]). Mann's thesis may be accepted as a general principle. In his „Proposal to Introduce the Income Tax" (1887). M. Matsukata, as was mentioned above, ascribed the causes of the introduction of the income tax into Japan to financial aspects such as the expansion of the expenditures and the reformation of the tax system. Matsukata's opinion seems to be a demonstration of the truth and universality of Mann's thesis. Now let us follow Mann's thesis and examine whether there were some factors that urged the introduction of income taxation, in the field of the public finance of Japan at that time, and the extent to which they affected its introduction.

(A) *Expenditures.*

First, let us consider the expenditures. Here, one of the more significant things to note is whether the public expenditure was increasing in the eighties. One characteristic of expenditure at this time was relative stability in its total amount. The total public expenditure was rather constant during the seventeen years ,(from 1877 to 1894), lying between the two periods of rapid expansion in the expenditure — the first decade after the Meiji Restoration and the years after the first Sino-Japanese War of 1894—95 [14]). Therefore, the factor for promoting its introduction was not to be found in regard to the total amount of expenditure. (But, the expenditure may be said to have substantially increased in some measure [15]), if it is taken into account that the period after 1882 was deflationary as the result of an effort to readjust the inflation of inconvertible notes in the seventies). But if we examine the phases in more detail, it is not impossible for us to find some factors which

[13]) F. K. Mann, Beiträge zur Steuersoziologie, Finanzarchiv, N.F. 2 vol., 1934, p. 311—314. Idem, zur Soziologie der finanzpolitischen Entscheidung, Schmollers Jahrbuch, 57. Jahrg. 1933, p. 705, 706.

[14]) The public expenditure of that time was as follows: —

year	1867	1871	1877	1879	1881	1883	1885	1887
expenditure	30.	57.	48.	60.	71.	83.	61.	79.
year	1889	1891	1893	1895	1897	1899		
expenditure	79.	83.	84.	85.	223.	254.	(yen millions)	

[15]) The wholesale price index during the 15 years, 1877—1890, was as follows:

year	1877	1878	1879	1880	1881	1882	1883
wholesale price-index	53	60	66	59	67	59	51
year	1884	1885	1886	1887	1888	1889	1890
wholesale price-index	53	56	55	56	59	62	65

Source: Yuzo Yamada, "Materials for National Income Estimates of Japan (Japanese), Tokyo, 1951, p. 154.

were to promote the introduction of the income tax, though they were not very strong. In this case, we should pay attention to the interrelation between war and the income tax [16]).

In those days the Government had to promote the defence of the country at any cost, for the strained international relation between China and Japan caused by the trouble about Korea threatened to develop into war. In consequence, increased expenditures were needed for expanding armaments, and for building warships. In 1882 the Government tried to cancel the inconvertible notes and promulgated a slogan of "retrenchment of expenditure" in order to keep economic conditions from disorder, and it was doing its best to retrench the administrative expenditures. (It was proposed by the Government that the administrative expenditure should be the same as it was for the 3 years after 1882.) So the Government must have intended to meet the increase of military outlay at the cost of administrative expenditures. Nevertheless, by 1886, there had appeared a danger that "retrenchment of expenditure" might not be maintained owing to the expansion of armaments. The first innovation that the Government took up with a view to covering the deficit was the floating of the "Naval-bond" and also the introduction of a new tax (the income tax), to supplement this to some extent [17]).

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[16]) A Japanese professor of fiscal science says that, in studying the characteristics of the income tax in Japan, we must realize that the immediate motive of its introduction was the increasing military outlay. I think his opinion is a common thesis that applies also to foreign countries (for example, Great Britain). We ought to recollect the fact Mann treats the general relation between the outbreak of war and the introduction of the income tax. (cf. Mann, Beiträge zur Steuersoziologie, p. 187--192).

[17]) The proportion of the military expenditures to the total expenditures between 1881 and 1889 was a follows: —

Year	Total (a)	Army (b)	Navy (c)	b/a	c/a	(b+c)/a
1881	71.48	8.20	3.01	11.5	4,2	15.7
1882	73.48	8.58	3.16	11.7	4.3	16.0
1883	81.03	9.69	3.09	11.9	3.8	15.7
1884	76.63	10.61	3.19	13.9	4.2	18.1
1885	61.11	9.60	2.63	15.7	4.3	20.0
1886	83.22	11.84	8.89	14.2	10.7	24.9
1887	79.45	12.63	9.81	15.9	12.4	28.3
1888	81.50	12.97	9.80	16.3	12.1	28.4
1889	79.71	14.26	9.32	17.9	11.7	29.6

(yen millions)

(B) *Fiscal Revenue.*

Next we shall take up the fiscal revenue. During the ten years from 1877 to 1887, Japan got out of an abnormal financial situation in which the fiscal demands had been defrayed mainly by loans and the issue of inconvertible notes, and was about to enter the stage of the so-called "Steuerstaat". At that time 80 % or 90 % of the whole fiscal revenue came from taxes. The tax revenue was chiefly from the land tax and the *sake* (a sort of liquor) manufacture tax. The main items of revenue were as follows:

	Total Revenue (a)	Total Tax Revenue (b)	Land Tax (c)	Sake-m. Tax (d)	Income Tax (e)	c/b	d/b	e/b
	(yen millions)							
1881	71.48	61.67	42.37	10.14		70.3%	17.3%	
1882	73.50	67.73	43.34	16.32		64.0%	24.2%	
1883	83.10	67.65	43.53	13.49		64.5%	19.5%	
1884	76.66	67.20	43.42	14.06		64.7%	21.0%	
1885	62.15	52.58	43.03	1.05		81.7%	1.9%	
1886	85.32	64.37	42.28	11.74		67.3%	18.3%	
1887	88.16	66.25	42.15	13.06	0.52	63.7%	19.7%	0.8%
1888	92.95	64.72*	34.64	17.06	1.06	53.7%	26.4%	1.6%
1889	96.68	71.29*	42.16	16.43	1.05	59.3%	23.0%	1.5%

* = total inland tax revenue.

As is clear from the above table, tax revenue was the chief source of fiscal revenue, and the land tax played the most important rôle in it. Land tax was a tax imposed mainly upon agriculture, but there were still no national taxes imposed directly on the industry and commerce which had already been dveloping to a remarkable extent. These were obviously far from impartial. Of course the inequality had been considerably mitigated by the business tax which had been imposed as a local tax since 1875. (The yield of the business tax was ¥ 2,930,000 in 1886.) Nevertheless, the arrearage of the land tax of that time demonstrated that it was too heavy a burden for the farmer, especially in the days of deflation about 1885. Then the second important tax was indirect taxes, such as the saké-manufacture tax, which were generally imposed on the necessaries of life, so we may call it "Massenbesteuerung". In addition to these, the deflation which resulted from the cancel-

lation of inconvertible notes was making it more and more difficult to collect taxes. Such being the case, in order to secure the revenue, the Government was obliged to resort further to indirect taxes, creating stamp duties, imposing taxes on medicine and on the brokers in both the rice and the stock exchange (1882), and taxes upon *shoyu* (soy) and cakes (1885). Now that such were the circumstances Matsukata might well have said: "Under the existing tax system, we can not expect to increase the revenue simply by raising the rates. Now it is the time gradually to reform the tax system" [18]).

However, it is doubtful whether these straitened financial conditions were the decisive factor in the introduction of the income tax. For in those days the scale of public finance was growing larger and larger every year, and there must have often existed such a degree of straitened financial conditions as have been mentioned above, both before and after 1887. So it would be too much to say that the financial conditions of the time were the most decisive factor in introducing the income tax. Mann's sociological theory of "finanzpolitische Entscheidung" is not particularly effectual in explaining the introduction of the income tax into Japan.

2) *M. Matsukata and the Introduction of the Income Tax.*

In my opinion, the most significant factor was the passion for justice which Mann excludes from his list of decisive factors. M. Matsukata, one of the most talented Finance Minister of Japan, was the principal promoter of its introduction. As he had contributed greatly toward its introduction, we cannot study it without taking account of his opinions and practices in financial policy. Next we shall examine the process of its introduction in connection with his opinions and practices.

Formally it is evident in any stage of history, that the taxation principle should ensure equality in the burden of taxes. In Japan, requirments of the equality principle arose soon after the Meiji Restoration. In 1874, M. Matsukata suggested the adoption of some rational tax principles in the fiscal code of Japan. But the idea remained as a formal slogan without substance [19]), and could not

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[18]) cf. M. Matsukata, The Proposal to Introduce the Income Tax, 1887.

[19]) The "Suggestions" proposed by M. Matsukata in June, 1874, begin with the following words: — "The essential functions of taxation should be for the governing part to make a system of equality and simplicity with which to give impartial administration, and for the governed to be always ruled well enough to have no grievances." Moreover, from the modern view-point, this writer insists that, in assessing taxes, allowance should be made for the psychic state of the taxpayer; the source of production should not be destroyed; and a tax created newly would possibly be deemed to be a bad tax.

be embodied in the actual tax system till 1887. The reasons for the above were chiefly as follows. First, for some years after the Meiji Restoration of 1868, the Government had a considerable number of problems to deal with. Besides, it was very difficult for the Government to secure revenue enough to support an enormous sum of expenditure which was called for under the circumstances of the time. So the Government was forced to levy as many taxes as possible, no matter what sorts of taxes they might be. In other words, the financial condition was so pressing that the Government could not afford to apply modern taxation principles on the actual tax system. Secondly, the leading financiers and statesmen of the time had no good knowledge about income tax or other modern methods of taxation in foreign countries. Even if they had some, the political, economic conditions were still too immature for them to carry out those new ideas in practice [20].

Towârd 1877, however, Japan gradually put on the appearance of a "Steuerstaat". Both equity in the burden of taxes and security of the tax revenue become more significant to the finance of Japan. And these were made momentous by the indications of increase in the national expenditure due to expanding armaments and the difficulty in collecting taxes owing to the deflation in the eighties. It can be clearly recognized through his draft of the income tax law in 1884 that, just then, M. Matsukata was projecting the introduction of the income tax. Indeed his draft is worthy of notice when we take into account the financial and economic conditions of the time. Here, M. Matsukata enumerated its items and wrote down the detailed explanation of each of them with his own hand. It was so perfect that it could have been carried into effect at once, and seems to have played a decisive rôle in introducing the income tax three years later. There are few data which inform us of the concrete development of his draft during these three years, that is, from the year 1884 in which he finished the drafting to 1887 when it was enforced. But the outline of its course may be conjectured as follows.

According to his draft of 1884, it seems that M. Matsukata intended to create the income tax on the model of British tax

[20]) Probably the concept of the income tax was first introduced to Japan shortly after the Meiji Restoration in 1868, for an explanation of it was found in a book which was published at that time. It is a noteworthy fact that in 1874 K. Rudolff, a German, made up a draft of a sort of income tax, taking "Die Klassen- und klassifizierte Einkommensteuer von Preuszen" for model, and presented it to Prince Hirobumi Ito, Councilor of State. Considering that the Income Tax Act of 1887 resembled the Prussian system, the draft by Rudolff must have had some indirect influence upon its introduction into Japan. But the extent to which the draft affected it is not clear. cf. S. Shiomi, "Income Tax in the Great States" (Japanese), Tokyo, 1934, p. 247—260.

systems [21]). Somewhat later, however, he thought it would be technically difficult to carry it out into practice. In 1886, he expressed the following opinion: "Introducing the income tax is appropriate to the present financial situation, but ascertaining the tax amount of each individual is very difficult especially under the projected income tax system." So it would be more beneficial to follow the example of the Prussian income tax system, because "its methods of assessment and collection are the simplest, and very suitable to the present circumstances in Japan. Now an inquiry into the Prussian tax system should be set about at once, for it is expected that the assessment and the collection of the income tax may begin in and after the next fiscal year." Thus, the draft of 1884 was forsaken, and the new draft which was the base of the income tax in 1887 was drawn up on the result of the inquiry into the Prussian tax system [22]). In short, the most significant factor of introducing the income tax into the fiscal code of Japan was the fact that it had already existed in some foreign countries, and M. Matsukata was determined to inquire into it so as to bring it into Japan. Then, one of the most characteristic points of the income tax of 1887 was that it was one of the imports, like culture, institutions, and sciences which were all introduced in the latter half of the 19th century. In general, the less advanced a country is, the more frequent are cases in which modernization is promoted chiefly with the lead of a talented statesman or a high official of the Government. Japan was

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21) I will give an outline of Matsukata's draft in 1884. According to the draft the income tax is imposed on total annual incomes of ¥ 500 and over, corporations and individuals being treated in the same way. Some rates were progressive, others proportional. The rate of progressive on total income was imposed on business income; proportional on the interest of bonds and debentures, on dividends, on salary of officials, etc. The rate of progression was as follows; on incomes from ¥ 500 up to ¥ 650, 2 %; from ¥ 650 up to ¥ 900, 2.5 %; and incomes of ¥ 900 and over paid 3 %. The proportional rate was 3 %. Income from business was assessed directly, while the interest of bonds and deventures, dividents, salary of officials, etc. were taxed at the source. In the case of direct imposition, the taxpayer had to make return of his income secured during the previous year to the governor of his district. The governor decided the amount of income tax on the base of the decision of the income tax commissioners. The tax was paid four times a year.

By 1884, not only Great Britain but Italy, Switzerland, Saxony, Prussia, etc. had already introduced the income tax as an ordinary tax. But the British income tax system seems to have been the model for Matsukata's first draft, because the British tax system and his draft were the same in their fundamental forms of taxation; schedular taxation and source collection.

22) The object of the inquiry was the "Die Klassen- und klassifizierte Einkommensteuer" in Prussia. The Japanese income tax law of 1887 was coincident with the Prussian tax system as to its fundamental character, namely lump-sum taxation.

no exception. In the latter half of the 19th century the whole financial system was turned remarkably toward modernization by the effort of M. Matsukata. And the introduction of the income tax was also dependent mainly upon his financial skill and political ability. Of course, I am not inclined to insist that he promoted its introduction with a thorough insight into the modern character of the income tax and its significance in the modern state. In any way, we should take account of the fact that he gave attention to some aspects of its modern character, and in consequence the tax system of Japan turned toward modernization.

Thus we understand, however roughly, the reasons for establishing the income tax in Japan. Then we enter into the examination of some characteristics peculiar to its establishment.

3) *Some Characteristics in Introducing the Income Tax into Japan.*

It is noteworthy that the income tax law of 1887 was modelled after the lump-sum taxation in Germany, while in Matsukata's draft of 1884 the British mode of taxation by the schedule system was adopted. Thus the fundamental mode of the income tax was altered from the British to the Prussian style within the short time of only three years.

But I am not inclined to pursue deeply the meaning of the reason for the alteration [23]). Of course in studying the characteristic features of introducing the income tax in Japan, this fact is too significant to be disregarded. If we look for such precedents, a few examples are found in Europe. But in these cases, the fundamental reason for alteration of the basic principles was essentially different

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[23]) As we have seen, M. Matsukata gives the reason for altering the basic principle as follows: — it is difficult to ascertain the tax amount of each individual. And the Prussian class and classified income tax is suitable to the present conditions of Japan. In general, however, the taxing process is in many respects simpler in the British schedular taxation (the model for Matsukata's draft in 1884) than in the Prussian lump-sum taxation (the model for the income tax law in 1887). As a matter of course, the former ought to have been more suitable to less advanced countries. Nevertheless, M. Matsukata was of opinion that even the British mode was too difficult to put into practice. The Prussian model of lump-sum taxation which demanded higher social conditions ought then to have been even more unsuitable to Japan. How can his opinion be explained? I surmise he must have thought that, though it appeared difficult to carry out, the lump-sum taxation would be simpler if the tax liability was calculated mechanically in the Government office on the basis of the taxpayers return. In other words, the social conditions were in such a low state that even the taxation by the schedule system was very unsuitable, and, therefore, the Prussian mode of taxation would be, in a sense, rather convenient for Japan. From the point of view of such a paradox, his ground for altering the basic principle in the mode of taxation must prove the immaturity of the social conditions for establishing the income tax.

from that of Japan[24]). In European countries, there had been established their own traditional and inherent tax systems, and the income tax was produced as a result of the gradual development of these systems. On the other hand, in Japan, the alteration was such as to suggest that the introduction of the income tax resulted from an isolated and abrupt attempt. In other words, it was unexpectedly introduced in Japan, before its characteristics and significance were well understood, that is, before the conditions for introducing it grew fully mature. Then, is it proper, from the historical and social standpoint, to consider that the introduction of the income tax was unexpectedly and abruptly carried out in Japan? In order to verify this, we must examine concretely the social foundation of the time, and discover the characteristics peculiar to its introduction.

(A) *The Outline of the Social Economic Conditions of Japan at that Time.*

As we have seen, the modern income tax can exist only under a rational political and economic system of a country. It is very interesting to note the fact that in Japan the income tax was a product of the period during which the modern state, the modern political system, and capitlism were established, at least in appearance.

First of all we should consider the change in the political system from about 1877 to about 1890. The political effort of the succeeding Governments after the Meiji Restoration was concentrated on the thorough destruction of feudalism and on the building up of the modern state. Towards 1885, Japan gradually emerged as a modern state. The Imperial Edict, promising establishment of the national assembly was proclaimed in 1881, and the Diet was opened in 1890. The modern cabinet system was organized in 1885, and the Constitution was promulgated on 1889. In short, the course of the political organization was directed toward modernization, and the parliamentary constitutional state as the foundation of the political system was established in those days.

Thus the modern bureaucratic administration came gradually into operation. I am inclined to mention some of these modernizations which were closely connected with the introduction of the income tax. The Imperial Diet came to put under its control financial af-

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[24]) In Great Britain W. Pitt created the lump-sum income tax in 1779, but Addington replaced it with the method of collecting at the source by the schedule system in 1803. And Addington's method has survived to the present day in principle. However, Addington's reason for altering the basic principles was both experimental and practical. In other words, the alteration was made from the viewpoint of the efficiency of collecting the tax.

fairs, such as budget, taxation, etc. which had hitherto been determined arbitrarily by the Government. The Constitution distinctly provided not only for liability of the people to pay taxes, but for the competence of the state to levy taxes. These relations were made clear by the enactment of the national tax collection law (1889). The reform of the organization of the Financial Ministry in 1886 was a very significant event for the financial administration. The accounting law had been subject to repeated improvements since its proclamation in 1881 and in February 1889 a distinct reform was made in the law after much inquiry into the systems in Europe and America. Thus the financial and administrative systems were rationalized and they put on a modern appearance.

Next let us look at the economic conditions of the time. After the Meiji Restoration, there had been rapid industrial and economic progress every year under government subsidies and encouragement. From the point of view of output, therefore, it may not be proper to say that only the short period of about ten years following 1877 brought an extraordinary development. In the economic system, however, the case was rather different.

During the years from 1877 to 1881, most of the farmers and the unfortunate people who had been deprived of their feudal positions as vassals through the Meiji Restoration, and consequently had been obliged to engage in commerce and industry to sustain their existence, were reduced to proletarian status on account of the inflation of non-convertible notes. On the other hand, rich merchants and fortunate people, now engaging in business, but originally coming from the vassals or gentry, grew to bourgeois. Then, somewhat later, there arose a deflation resulting from the readjusting of the inflation of inconvertible notes. Of course the deflation served as a promoter in forming the two classes — proletariate and bourgeoisie — as was the case with the inflation of a few years before. So it may well be said that in those years Japan came to display first her characteristic appearance of capitalism. Meanwhile extraordinary advantages were given to the capitalists in industry which was under the protection of the Government, and enormous profits were made by some great capitalists from the transfer of Government factories. Thus the accumulation of their capital increased and centralized rapidly. Moreover, the Bank of Japan was established in 1882, and then the financial system was rapidly put in order. Now the steady foundation of the economic system was accomplished.

All things considered, we may say that during the period from 1882 to 1887 there were entirely swept away the feudal remnants which had survived the Meiji Restoration of 1868, and simultane-

ously there was strengthened the foundation of the capitalistic development of Japan [25]).

The observations above lead to the conclusion that, towards 1887, the social and economic system of Japan had at least a fairly modern appearance.

(B) *The Peculiarities of the Social Economic Condition of Japan.*

Then, is it proper to consider that the introduction of the income tax into the fiscal code of Japan was enforced under modern social conditions, just as in European countries?

Here, attention must be called to the fact that there was a clear distinction between the modernization of Japan and that of European countries. In Europe, modernization was promoted both in the social life and in the social system, while in Japan, it took place chiefly in the social system alone. The modernization of the social system in Japan, however, can be understood only in connection with the intentional and radical effort of the Government to hasten the modernization of their systems by taking up and mimicking the social systems of advanced countries in Europe. As a matter of fact, a gradual and substantial modernization process is a characteristic phenomenon peculiar only to the modern European world. On the other hand, modern development in the formal system of

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[25]) Below are given two tables for the better concrete comprehension of the annual economic development.

The Quantity of Mineral Products: —

year	gold	petroleum	iron
1874	97 KG.	54 KL.	5.6 KT.
1882	270	378	12.0
1887	595	540	15.0
1897	1,080	4,160	29.0
1907	2,900	27,300	52.0

THE NUMBER OF BANKS AND THEIR CAPITAL

year	Main Shop	Branch Shop	Capital (yen thousands)
1877	26	19	2,299
1882	144	121	4,723
1887	138	127	6,033
1892	135	142	6,282

Japan preceded substantial modernization. Indeed, the social system of Japan was fairly modernized in the European sense, but in substance it seemed to be full of Oriental irrationality and its characteristics were far from modern. It is very interesting to examine the essential difference between the modernization of Japan and that of Europe. But this is a problem too deep for us to give a hasty conclusion [26]). In any case, the introduction of the income tax into the fiscal code of Japan must be considered as a chain of Government efforts to hasten the modernization of political and administrative systems. For the social-economic condition of the time was probably, from the point of its substance, not mature enough to comply with its introduction. The substantial non-modernity of Japan in those days was reflected mainly in the social consciousness of the daily life of the people. They almost did not realize the strength of public opinion, and consequently their critical ideas about social affairs were comparatively inactive. The Oriental idea of being too ready to resign themselves to their destiny, and the habit of giving themselves up to meditation, had deeply penetrated into the consciousness of the Japanese in their daily life, so that probably humanistic and democratic ideas could not easily take root among them. Indeed, little did they recognize the significance and the value of democracy. Moreover, even among the leading economic critics there were some who did not know well what the income tax was. Thus, there was a gap to some extent between the effort toward hastening the modernization of the system by high officials of the Government and the social consciousness of the people (including the intellectual class). The high officials of the Government worked towards modernization, but of course it was without any thorough insight into fundamental character of modern society. Thus, it was due to the zigzag process of the modernization of Japan that the fundamental mode of the income tax was altered within as short a time as three years, and that on the ground of technical difficulty it was altered by the adoption of the mode of lump-sum taxation which required a higher degree of technique.

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[26]) Some learned men have pointed out that an essence far from the modern character was hidden behind the superficial modernization on the phase of social economic life. K. Tsuji, professor of political science in Tokyo, opines as follows —

Formally, the establishment of the modern cabinet system in 1885 indicates the political and administrative modernization of Japan. Examined further in some detail, however, the clan character inherent to Japan proves to have been substantially preserved in such a modernized system. Thus, it is the very peculiarity of the political and administrative systems of Japan that under the superficial modernization of systems, some remnants that are far from that of modern character are concealed. cf. K. Tsuji, Studies in Bureaucracy in Japan, Japanese, Tokyo, 1952.

Again, indeed the income tax in Japan was of fairly modern character in its system, but substantially the social condition was not mature enough to put its modern character to practical application. Now I think the peculiarities surrounding the introduction of the income tax have become apparent enough to be closely connected with the characteristics in the social economic conditions of Japan.

4) *The Factors leading to Success in the Establishment of the Income Tax in Japan.*

The income tax was introduced and established under immature and peculiar social conditions, but it was of modern appearance as to its system. It is worthy of wonder that, in spite of the above contradiction, the tax developed with considerable success. How can we explain the success of the tax which was inconsistent with the general principles we have considered before? To explain these is the last problem of our essay. In considering our problem, we must take particular notice of the peculiarity of the social conditions in Japan at that time. It will be of some help to its solution to examine the relation between the first income tax and these peculiarities. I will mention several factors leading to its success chiefly from such a standpoint.

(A) The rate of the income tax was exceedingly low. Though the return system was adopted, most returns were accepted without revision. The amount payable for the tax was, therefore, very small in comparison with taxpayer's income, and the return was made at his discretion to some extent. Consequently, the burden of the tax turned out to be very light. Then, from the point of the tax collector, levying the income tax was comparatively easy, and, in most cases, little consideration was necessary for the taxpayer's morality and for the shortcomings in the method of levying it.

(B) At that time, the social consciousness of the people was remarkably inactive. This was not only due to their attitudes of living which were, by nature, indifferent to society, but it also resulted from the compulsion laid by the Government on the people to promote the rapid modernization in systems. People then understood nothing of the income tax. Of course, there could be no public opinion or demonstration against the tax. The Diet, which was to reflect their opinion, had not been established yet. They were ready to respect government authority, and to submit to it as a matter of custom. These social circumstances had been traditional in Japan since the Meiji Restoration. In such circumstances, there could be no objections of the people against the income tax which had been introduced by the Government. In fact, real democracy was a thing unknown to them. Moreover, as the corporation was free from the

tax the businessmen and industrialists, who were most likely to oppose it, seemed to be indifferent to it. It is interesting to contrast this with the fact that, in Great Britain, the Income Tax Bill of Pitt met vehement opposition both inside and outside the House of Parliament. Thus the modernization process of Great Britain and that of Japan were quite different in their substance. In Japan, after 1890, there existed high property qualification for the electorate (payment of at least fifteen yen in the direct national taxes). Income taxpayers were then respected in society as wealthy men. And it prevented the evasion and the arrearage of taxpayers. After all, we come to the curious conclusion that some thing which was far from that of modern character on the side of the taxpayer — together with the effort of the Government towards the modernization of their systems — was one of the factors leading the income tax to success.

Before the modernization of the social conditions became mature, high officials of the Government had already been attempting to modernize every political and administrative system since the Meiji Restoration. So whatever way it was regarded, both officials and people of the time could afford to keep pace with the introduction of an income tax system which was too modern for the conditions of Japan.

The first income tax established in Japan was of such a sort as could be carried out easily. The social consciousness of the people of the time was so inactive that there was little room for any objection to raise against the income tax. Many attempts had already been made to promote the modernization of the social system since the Meiji Restoration. Because of these conditions as a whole, the income tax in Japan probably met with a certain measure of success.

L'ETABLISSEMENT DE L'IMPOT SUR LES REVENUS AU JAPON (ETUDE HISTORIQUE & SOCIOLOGIQUE)

par Kotaro Ikeda

RÉSUMÉ

L'impôt sur les revenus a le caractère global, quantitatif et subjectif; par conséquent, il est un phénomène moderne. Le succès de l'établissement de cet impôt dépend principalement du niveau de la modernisation de ce pays. Cependant ce principe n'est pas bien adaptable au Japon. Lors du premier établissement de cet impôt au Japon en 1887, les conditions sociales de ce pays ne sont pas encore assez modernisées. Mais le système de l'impôt sur les revenus ne cesse pas de progresser avec succès au Japon. Dans cette étude, je tâche de dégager cette particularité de l'établissement de l'impôt sur les revenus au Japon par le moyen de ce principe général et de l'analyse des conditions sociales concrètes. (Chapitre I).

Pour l'établissement de l'impôt sur les revenus en 1887, le gouvernement adoptait l'impôt sur les revenus globaux avec déclaration des contribuables. Le taux était progressif sur la somme globale des revenus et son maxima était 3 %. Ce système lui-même a un caractère assez moderne. Mais cet impôt n'apportait pas beaucoup au gouvernement. Au commencement, l'impôt sur les revenus au Japon n'était pas important comme fournisseur de revenus gouvernementaux. La signification de l'établissement de l'impôt sur les revenus au Japon se trouvait dans la possibilité de la modernisation de ce système complet de l'impôt. (Chapitre II).

Cependant les impôts sur les revenus évoluaient avec succès. Dans le chapitre III, vous trouverez les analyses sur les facteurs de succès, et la particularité de l'établissement du système des impôts sur les revenus en relation avec les conditions sociales particulières au Japon.

Tout d'abord les facteurs d'introduction du système des impôts sur les revenus au Japon: la situation financière du Japon à ce moment là n'exigeait pas décisivement d'y introduire des impôts. L'impulsion de cette introduction se trouve dans les efforts de Matsukata, Ministre des finances, pour moderniser le système d'impôts.

On trouve beaucoup de particularités dans l'établissement de l'impôt sur les revenus. Par exemple, dans le projet de l'impôt sur les revenus que Matsukata a rédigé en 1884, la méthode de la retenue à la source était discriminatoire. Mais sous le prétexte de diffi-

cultés techniques dans l'exécution par l'administration fiscale, ce projet fut rejeté et l'impôt sur les revenus globaux par la déclaration des contribuables fut finalement établi. Et ce système exige, semble-il, une haute technique fiscale. Voilà une des particularités mais ces particularités dépendent principalement des caractères de la modernisation des conditions sociales au Japon. Par exemple, au Japon, la modernisation des institutions s'avançait plus rapide que celle des consciences sociales. C'est un des exemples des particularités de la modernisation du Japon.

Nous vous présenterons les facteurs de succès dans l'établissement de l'impôt sur les revenus; 1° Ce système est bien facile à exécuter. 2° L'habitude des citoyens japonais d'obéir aveuglement à l'autorité officielle et gouvernementale, c'est dire qu'à cause du retard de la conscience sociale des peuples japonais, le danger de la résistance à l'impôt sur les revenus établi par le gouvernement n'existait pas parmis ces peuples. Les hauts fonctionnaires du gouvernement ont essayé diverses modernisations de l'institution avant que soient suffisamment modernisées les conditions sociales depuis la restauration de Meiji. Aussi, le gouvernement et les peuples pouvaient-ils collaborer ensemble à l'établissement de l'impôt sur les revenus qui nous semble être trop moderne, vu les conditions sociales de cette époque au Japon. La collaboration de ces facteurs permet de développer, en général, le système de l'impôt sur les revenus avec succès dans ce pays. (Chapitre III).

FISCAL EXPERIMENTS IN EASTERN NIGERIA

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In March last year the Eastern Nigeria Government embarked upon a series of fiscal measures which, if successful, may influence profoundly the fiscal climate in underdeveloped countries. It instituted a Regional income tax as distinct from the Federal income tax (with the incorporation of a regionally operated P.A.Y.E. system), an entertainments tax and a 'Purchase tax' system [1]). These are all not novel fiscal devices although some aspects of them are new in Nigeria. What is revolutionary about the Finance Law is that what orthodox teaching had deemed to be administratively impossible in underdeveloped territories has been shown to be quite feasible. It is interesting to see how this disadvantage is or is to be overcome and we shall examine that presently. But first as to the background. It is impossible to understand the Finance Law without an insight into that background and once that background is appreciated everything else becomes intelligible.

In 1950 Nigeria, which since 1910 has been administered as a unitary 'State', set out on an experiment with federal government. For this purpose, Nigeria was divided into three regions — North, West and East. The basis of their revenue arrangements was laid down in the recommendations of the Hicks/Phillipson Commission on Revenue Allocation [2]). When the Constitution was further modified in 1953 these financial arrangements were again reviewed by Sir Louis Chick whose recommendations formed the basis of the finances of the units of the new federation. Naturally, in this age when the *economic impact of underdeveloped countries* is resounding throughout the world these resources are not enough and the Eastern Regional Government has felt itself like a '*genius in prison*'. The reasons for this are not difficult to discover. Not only is the Eastern Region (discounting the Southern Cameroons Trust Territory) the smallest expanse of Nigerian territory, but also it is absolutely the poorest or at least poorer than the Western Region. The per capita incomes of the African population by regions is estimated to be as follows:

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[1]) These measures were embodied in a single legislation entitled the Finance Law E.R. No. 1 of 1956.

[2]) Report of the Commission on Revenue Allocation — 1951 (Lagos).

	(£)	
	1950/1	1951/2 [3])
Northern Region	15	17
Western Region	31	34
Eastern Region (including Southern Cameroons)	19	21

Its inland waterways teem with fish and it has some palm kernels. But its soil is poor and although it is blessed with an industrious people the land is unyielding. One of the most striking facts which hits the visitor to Eastern Nigeria in the eye is the continuous chain of advertisements of artificial fertilizers in almost every shop he goes into. This is a certain index of the poverty of the land in that region. Significantly enough the outline development plan of the region covering the period 1955—1960 gives the lowest consideration to agriculture as the following summary of the plan reveals.

Service	Total Allocation (£) [4]) 1955/60
Rural Water Supplies	1,750,000
Roads & Bridges	804,000
Education	1,000,000
Health	500,000
Agriculture	45,000
Fisheries	100,000
Veterinary	200,000
Reserve	800,000
Total	5,200,000

The explanation of the apparent paradox lies in the fact that the government has recognised that Eastern Nigeria's course of development does not lie in agricultural development but in other directions. This means that, unlike other underdeveloped Colonial territories, she can have very scanty primary products from which to derive a revenue for development and the whole business of government financing becomes precarious. "In view of the limited financial resources of the Region, there is need for widening the periphery of our fiscal potential" wrote the authors of *Economic Rehabilitation of Eastern Nigeria* [5]). Eastern Nigeria is, however, rich in one respect, namely, in the quality of its human resour-

[3]) Source I.B.R.D.: The Economic Development of Nigeria, p. 398.
[4]) Ex Sessional Paper No. 4 of 1955 (Eastern Region), p. 2.
[5]) Opus. cit., p. 15.

ces. It is the home of the restless, but resourceful, adventurous and pushful Ibos who are also very clever. Denied opportunities for agricultural development they have pinned their faith in industrialization and trade which should be maintained from the outset on the highest possible level of efficiency. The development of education at all level, of health and of first class communications is given a high priority. If their plans for communications development materialise in the quinquenium there is no doubt that Eastern Nigeria will have the best and most efficient land communications in West Africa if not in Africa South of the Sahara. But this is not being done from mere vanity. It is a matter of life and death with the region so that its manufactures may flow out of the region as cheaply as possible and its imported goods received in the same manner. Moreover, this government contemplates the establishment of a modern Welfare State with a national social security system [6]).

Given this background and the will to economic progress, the urgency to exploit *all* available sources of income to provide the sinews of development become intelligible. In addition, if a modern Welfare State with a national social security system is to be at once established as of right then the correlative obligation is that the community as a whole must provide the means to its establishment and maintenance. This illumines the fact that the Finance Law has attempted to reach all the sources of revenue within the community. Fundamentally the Law appears to discriminate against Africans. Obviously, where skills are still to be imported for development it is necessary that some incentive should be given for their supply. But a more important reason is because the non-Africans are already covered by the Federal income tax.

Chapter IV of the Sessional Paper *Economic Rehabilitation of Eastern Nigeria* is devoted entirely to arguing out the case for independent sources of regional fiscal income. That in fact was unnecessary since it is an accepted fundamental principle that in a democracy — and it is even an essential lever for the promotion of a sound democracy — that states or provinces in a federal system and local authorities in a unitary system should have autonomous sources of revenue. Perhaps in a federation where *Law* is sovereign and where the conventions are so little understood this stressing of the obvious becomes important. The recommendations at the end of that chapter, however, give the impression that the Finance Law 1956 is only the first of a series of measures to raise more revenue from domestic sources in the Region.

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[6]) Economic Rehabilation of Eastern Nigeria — Sessional Paper No. 6 of 1955, p. 27.

The Law, in the first place, establishes a regional income tax which essays to replace the old Direct Tax. This Direct Tax was, in reality, a tax chiefly on net farming and fishing incomes. In reality the new tax tries to assimilate the old Direct Tax to the Federal income tax which applies to non-Nigerians. But it does more than mere assimilation of the two. In this respect, not only are the problems involved in the two similar but also the regional income tax and its administration should be more efficient than the federal tax if the experiences with the operation of the latter have been taken fully into account. What is a novelty in Nigeria about the Regional income tax system is the incorporation of the pay-as-you-earn system in it. This feature obviously is introduced to cover all categories of employed persons in the region including labourers. And it must be read in conjunction with the point made earlier about rights and correlative obligations although the Welfare State has not in fact been established but only its foundations being planned.

Instead of the more elaborate '*codes*' of the more advanced systems as in Britain the simplicity of the economic structure permits of a more simplified arrangement. A simple schedule of income tax rates is given for those with tax liability — a single person, married persons without children, married persons with not more than two children, married persons with three or more children — as they fall within certain defined income brackets. The tax rates are annual rates and it is left to the employers as tax collecting agents to determine from these the monthly rates to be deducted from the income of their employees. The usual tax deduction cards are provided for each employee as well as Transfer Note Cards and other notification for changes of employment etc. There can be no doubt at all that valuable lessons have been learned here from the administration of P.A.Y.E. in the United Kingdom since its introduction during the last war. But the most novel feature in the arrangements is the provision of *Revenue Stamp Cards* for daily wage employees. These daily paid labourers and workmen are to be provided with Revenue Stamp Cards to which are affixed revenue stamps to the value of the income tax to which they are liable at the receipt of each pay packet. The stamps are then cancelled by the employer as directed by the tax authorities. In this way the labourer carries with him continued evidence of his tax paid. The result is that practically everybody in the region pays taxes just as everyone would enjoy the benefits of the Welfare State.

Traditionally, it was argued that the costs of administration involved in taxing the lowest income groups such as labourers and casual workers would outweigh the results that it was not econo-

mical to try to do it. This difficulty is no less real in Eastern Nigeria. The new tax overcomes this first by transfering a good deal of the work of collection to the employers and managers of establishments (which the P.A.Y.E. facilitates), then by using the established local government authorities as tax collectors and tax collecting agents. The tax collectors in fact exercise all the functions of inspectors of taxes in the United Kingdom. In this way the cost of administration is economised. In a sense, this is one of the most revolutionary things about the new taxation. By a judicious use of already existing institutions in the Region it essays to overcome the economic disadvantage of taxing the lowest incomes — and indeed the whole community — which was hitherto thought to be well nigh impossible in an underdeveloped territory.

Nevertheless, the system still has its weaknesses. In the first place a highly progressive graduation principle is embodied in the schedule of tax rates. It is perhaps the most progressive system of taxation in West Africa at present and it is doubtful whether that will not lead to friction. It is much too early yet to judge the effect of this experiment but the government will need to use all the artifices of modern propaganda to convince the taxpayers that such rates are necessary and justifiable. Within the income brackets themselves the tax is regressive. There is, however, a declining degree of regression the further away we move to the higher income brackets. This is well illustrated in the following examples:

ome (£) (Range 201— 0.19.11d):	Percentage of tax:	Income (£) (Range £ 501— £ 600.19.11d):	Percentage of tax:	Income (£) (Ronge £ 2,701 £ 2.800.19.11d):	Percentage of tax:
201	13.4	501	14.3	2,701	19.9
250	10.8	550	13.09	2,750	19.6
300	9.0	600	12.0	2,800	19.2

This is the result of taxing brackets of income rather than establishing rates of tax per unit of income within income ranges. Apparently this method was adopted for its convenience in administration and economy. The anomaly can be reduced but not eliminated, in the short run, by narrowing the brackets but ultimately *codifying* is the answer. There are bound to be other minor frictions and evasions although the possibility of this should not be exaggerated. For as Lord Lugard has taught us those who pay the tax will be quick to resent the immunity of others [7]). There will be frictions due

7) G. F. Lugard. The Dual Mandate in British Tropical Africa, p. 250.

to loss of cards, accidents and so on which might necessitate intensification of administrative controls such as elaboration of records etc. This might in turn increase the costs of administration. The most significant anomaly about the new tax, however, is involved in the taxation of labourers incomes through the Revenue Stamp Card system. *The necessary condition for its success is a state of continuous full employment.* Except in a state of continuous full employment it is bound to be inequitable if highly regressive, and, if a drawback system were written into the arrangement, there is bound to be considerable pressure for drawbacks in face of fluctuations in employment or of unemployment that in the end the whole scheme will prove to be uneconomic. It might even break down. At the time of writing there is no certain information about the position although it would seem that where economic development is proceeding the economy may approach such a state of full employment. It may, therefore, be appropriate to institute the system at this time. But a temporary state of full employment is not enough. It must be sustained full employment. Otherwise the Revenue Stamp Card system is bound to lead to injustice and be the source of future difficulties. The success of this experiment would justify the case made by the author in 1953 for improvement of the income tax system [8]).

The entertainments tax is a liability on all entertainments except those promoted for financing philanthropic and charitable purposes and those of a wholly educational character or partly educational and partly scientific and conducted by a non-profit making society or institution founded for the reviving of traditional pastimes. The tax is again a very simple one and easy to administer. All entrance to entertainments is forbidden except by means of tickets stamped with unused stamp (or the equivalent by arrangements previously sanctioned by the Minister of Finance) of the value of the tax to be paid. A schedule of the prevailing tax is provided in the law and cannot be varied except by the ordinary process of amending the law. The existing schedule is as follows:

Price of Entrance	Tax
3d-6d	1d
7d-1/6	2d
1/7d-3/-	6d
3/1d-5/-	9d
5/1d and over	1/-.

[8]) Ref. Public Finance, Vol. 8 No. 2, p. 127.
[9]) Ref. Eastern Region of Nigeria Gazette, Vol. 5 Extraordinary, p. 66.

Proper safeguards are provided for its administration and enforcement.

The 'Purchase Tax', on the other hand, is practically a form of a *specific* import duty on petrol and drinks if these items are regarded as 'bonded' in the stores of the wholesale importers of them into the Eastern Region. Tax is a liability on a chargeable purchase of those goods. According to the law "a chargeable purchase is *the first purchase made from a wholesale merchant* selling by wholesale of chargeable items after such items have been brought into the Eastern Region or in the case of a purchase of unascertained items, items appropriated to the purchase which are in the Eastern Region at the time of the appropriation". (Italics mine) [10]). There is some ambiguity here. Either it may mean absolutely the first purchase made from the wholesale merchant or the first purchase from a consignment made by each retail dealer from the wholesale merchant. Possibly it is the latter which is meant. Otherwise there would seem to be no point in imposing the tax which could be easily evaded by understandings by which first purchases could be made minimal so as to impose very little *effective incidence* on the whole consignment.

Both the entertainments tax and the purchase tax are of the same order. They appear to be in the nature of a rough and ready type of "luxury" tax reflecting both the ability of those who consume those things to shoulder more of the burden of financing the government of the Region and the moral obligation to assume more of the costs of developing the Region. Indeed this is the silent theme running through the pages of the Sessional Paper *Economic Rehabilitation of Eastern Nigeria*. Those who are earning high incomes and enjoying higher levels of living in the Region are doing so because of the opportunities which had been opened to them for improvement. It is now their moral obligation, in turn, to help open up those opportunities to others and to the whole community. But the 'purchase tax' has the potentialities of a 'protectionist' weapon particularly for the new industries and that development cannot be discounted [11]).

The new taxes represent a heroic experiment in an underdeveloped country to exploit fully and intelligently domestic sources of

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10) E.R. No. 1 of 1956 see 55(2).

11) The goods that may ultimately be covered are of this nature and include cotton piece goods, corrugated iron and asbestos sheets, hollow-ware, private commercial vehicles, cement, bicycles, tyres, tubes, glass-wares, plate glass, engine oil, grease, aviation gas, diesel oil, fuel oil — Sessional Paper No. 6 of 1955, p. 18, n. 47.

development finance. If its weaknesses can be remedied — particularly those of the new income tax — there is no doubt that it will exert much influence in the area of West Africa if not in underdeveloped countries generally. Those anomalies are quite serious from the point of view of *equity* and a heroic effort must be made to correct them. Otherwise, not only will social friction be a constant threat to Eastern Nigeria but that might be the very announcement effect in any other place which does not have the same general social and political environment as Eastern Nigeria has but which tries to immitate such tax experiments. If these anomalies can be corrected quickly enough there can be no doubt that Eastern Nigeria is experiencing a financial revolution perhaps more fundamental than its spectacular political conflicts. The net result will, no doubt, be a higher and more generally diffused sense of political or civic responsibility and possibly a crusading zeal for economic and social development and the upsurge of a new democracy. That in itself will be enough to ensure that the Government stimulate that development itself and create the Welfare State which are the raison d'etre for the new taxation drive. The impact of this on adjacent lands will be profound.

EXPERIENCE FISCALE EN NIGERIA ORIENTALE

par le Professeur N. A. Cox-George

RÉSUMÉ

En mars 1956 le gouvernement de la Nigéria Orientale a mis en vigueur une série de mesures fiscales qui auront des effets considérables sur le climat fiscal des pays sous-développés. Ces mesures comprennent un impôt régional sur le revenu assorti du système de la retenue à la source, un impôt sur les spectacles, une taxe sur les achats. Une des caractéristiques saillantes de cette expérience est qu'elle a montré que ce que l'opinion orthodoxe avait déclaré administrativement impossible dans des territoires sous-développés, s'est trouvé être parfaitement réalisable.

Il faut avoir quelque connaissance des conditions locales pour être capable de bien apprécier le nouveau régime fiscal. La Nigéria Orientale constitue l'unité la plus petite et la plus pauvre de la Fédération de Nigéria. La pauvreté relative de la région est mise en évidence par le fait que le revenu par tête de la population, £ 19 et £ 21 pour les années 1950/51 et 1951/52 respectivement, y est beaucoup plus bas que dans la Région Occidentale, où ces chiffres étaient de £ 31 et de £ 34 dans les mêmes années. Il est vrai que les voies fluviales à l'intérieur du pays abondent en poisson et qu'il y a quelques cultures de palmiers, mais le sol est pauvre et, bien que la population soit laborieuse, le pays ne produit guère.

En effet il n'y a que très peu de matières premières susceptibles de promouvoir le développement. L'impossibilité d'améliorer la production agricole est reconnue par le Gouvernement qui, dans son plan quinquennal (1955—1960) se propose d'affecter à l'agriculture moins de 1 % des dépenses totales de développement, lesquelles se montent à plus de £ 5.000.000. Etant donné qu'il n'y a pas de possibilités de développement agricole, il a mis son espoir en l'industrialisation et en le commerce. En outre, il se propose d'établir un état social moderne, avec un système national de sécurité sociale. Dans ces conditions, et avec la ferme volonté de progrès économique, la nécessité urgente d'expoiter toutes les sources de revenu disponibles pour fournir l'armature financière du développement devient intelligible.

La loi établit tout d'abord un impôt régional sur le revenu, remplaçant l'ancien impôt direct ou plutôt assimilant l'impôt direct à l'impôt fédéral sur le revenu des Non-Nigériens. En réalité elle fait plus que cela. Elle introduit une mesure nouvelle en Afrique Occidentale: le principe de la retenue à la source. Le but est évidem-

ment de couvrir toutes les catégories de personnes employées, y compris les ouvriers non qualifiés. Au lieu des „codes" compliqués des systèmes plus avancés, la simplicité de la structure économique permet des modalités simples.

Un système simple a été établi pour déterminer les taux de l'impôt sur le revenu des imposables — les non-mariés, les mariés sans enfants, les mariés avec deux enfants au plus, les mariés avec trois enfants ou plus — selon qu'ils entrent dans des tranches de revenu défini. Les taux sont des taux annuels et on laisse aux employeurs, en tant qu' agents-percepteurs d'impôts, le soin de déterminér à partir des taux annuels les taux mensuels qui sont à déduire du revenu de leurs employés. On a pris les dispositions usuelles en ce qui concerne l'indentification et la notification de changement d'emploi, etc., ce qui montre qu'on a su profiter des leçons précieuses de l'expérience acquise au Royaume Uni avec le système de la retenue de l'impôt à la source. La principale nouveauté est qu'on fournit des cartes de timbres du fisc pour les employés à la journée. Les cartes portent des timbres ayant la valeur de l'impôt à payer sur le revenu. Les employeurs reçoivent des directives des autorités fiscales pour annuler les timbres à mesure que les obligations fiscales sont remplies, chaque jour de paye. De cette façon l'ouvrier porte sur lui la preuve constante qu'il a payé ses impôts. Le résultat en est que pratiquement tout le monde dans la région paye des impôts, tout comme tout le monde bénéficierait des avantages sociaux.

Traditionnellement, on a avancé que le coût de l'administration serait prohibitif. La nouvelle loi fiscale de la Nigéria Orientale a su vaincre cette difficulté en ce qu'elle transmet une bonne partie du travail de perception aux employeurs et aux directeurs d'établissements et qu'elle se sert des autorités gouvernementales locales déjà en place comme percepteurs et agents de perception d'impôts. En fait, ces percepteurs d'impôts exercent toutes les fonctions des inspecteurs d'impôts au Royaume Uni. Ainsi, par un emploi judicieux d'institutions existantes, cette loi surmonte le désavantage qu'il y a à imposer les revenus les plus bas, ce qui jusqu'ici avait été considéré comme impossible dans un territoire sous-développé.

Le système a aussi ses faiblesses. Le système des taux comprend le principe de progressivité; c'est peut-être le système de taxation le plus progressif de l'Afrique Occidentale. Ce fait risque de donner lieu à des frictions continuelles, à moins que le Gouvernement ne sache convaincre les contribuables que ces taux sont nécessaires et justifiés. A l'intérieur des groupes de revenus l'impôt est régressif, comme l'illustre le tableau suivant, bienque le degré de régression diminue à mesure que l'on monte dans l'échelle des revenus des groupes.

enu (£) roupe 201— .19.11d)	Pourcentage de l'impôt	Revenu (£) (Groupe £ 501— £ 600.19.11d)	Pourcentage de l'impôt	Revenu (£) (Groupe £ 2.701— £ 2.800.19.11d)	Pourcentage de l'impôt
201	13.4	501	14.3	2.701	19.9
250	10.8	550	13.09	2.750	19.6
300	9.0	600	12.0	2.800	19.2

Cette anomalie peut être réduite par un „rétrécissement" des groupes, mais une telle mesure ne saurait la faire disparaître à bref délai; finalement la solution pourra être trouvée dans une „codification". Il y a aura des difficultés par suite de perte de cartes de timbres, d'accidents, etc. qui pourraient nécessiter une intensification plus coûteuse du contrôle administratif. L'anomalie la plus sérieuse réside dans la taxation des revenus des travailleurs au moyen du système des cartes de timbres. La condition indispensable à son succès est un état continu de plein emploi. Sans plein emploi le système nu pourra être qu'inéquitable s'il est très régressif.

La taxe sur les spectacles est une contribution fiscale sur tous les spectacles à quelques exceptions près, tels des spectacles donnés dans des buts charitables, éducatifs et scientifiques ou constituant des passe-temps traditionnels. Cette taxe aussi est très simple et facile à appliquer.

L'entrée aux spectacles n'est permise qu'avec des billets munis de timbres non-oblitérés (ou l'équivalent) de la valeur de la taxe à payer.

La taxe varie de 1 d pour les billets de 3 d à 6 d, à 1/- pour les billets au-dessus de 5/1 d.

La taxe sur les achats est essentiellement une forme de droit d'entrée sur l'essence et les boissons, si l'on considère ces produits comme „entreposés" dans les magasins des grossistes-importateurs dans la Région Orientale. La taxe est une contribution fiscale sur le premier achat fait chez un grossiste. Il y a de l'ambiguité dans cette formulation qui peut signifier soit le premier achat fait chez un grossiste, soit le premier achat fait par chaque détaillant sur un envoi importé par le grossiste. Le premier sens ouvre des possibilités d'échapper à la taxe au moyen d'un „arrangement" tel que les premiers achats soient réduits au minimum, ayant ainsi une très faible incidence effective sur l'envoi tout entier.

La taxe sur les spectacles ainsi que la taxe sur les achats ressortissent à la même catégorie d'impôts — grossièrement elles constituent des taxes de luxe qui réflètent à la fois la capacité des consommateurs de ces marchandises de supporter le fardeau du financement des dépenses publiques de la région et l'obligation morale de prendre

à leur compte une plus grande partie des dépenses pour le développement de la région. La taxe sur les achats contient aussi un élément de protectionnisme, qu'on y a introduit peut-être pour aider les industries nouvelles qui s'établiront dans la région.

Les expériences décrites ici sont plutôt héroïques si l'on considère le fond sur lequel elles ont été tentées. Elles ne manqueront pas d'influencer l'opinion sur le financement des dépenses publiques, non seulement en Afrique Occidentale mais aussi dans les autres pays sous-développés, à condition que les anomalies, que présente surtout le système de l'impôt sur le revenu, puissent être surmontées et que la friction sociale causée par leur introduction puisse être écartée. Si elles peuvent être neutralisées assez rapidement, il n'y a pas de doute que la Nigéria Orientale passe par une révolution financière qui est peut-être plus fondamentale que ses conflits politiques spectaculaires. Le résultat net en sera, sans aucun doute, un sens plus élevé et plus généralement diffusé de responsabilité politique et civique et peut-être un effort fervent d'arriver à des améliorations économiques et sociales ainsi que la poussée d'une nouvelle démocratie. L'influence de ces résultats sur les territoires voisins sera très grande.